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No.

IN THE

Supreme Court of the United States

October Term, 1984

PEAT, MARWICK, MITCHELL & CO.,
Petitioner,

—against—

PETER MOSESIAN,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

1. Does federal equitable tolling doctrine suspend the statute of limitations in Rule 10b-5 actions until a plaintiff, without inquiry, is confronted with facts which necessarily lead him to his ultimate legal conclusion of "securities fraud," or must a plaintiff, once aware of facts sufficient to excite attention and call for inquiry, conduct a duly diligent inquiry to preserve his claim.

2. Does the Seventh Amendment preserve any right to a jury trial for purposes of determining whether the statute of limitations should be tolled pursuant to federal equitable tolling doctrine?

3. Should the limitations period set forth in Section 18(c) of the Securities Exchange Act of 1934, 15 U.S.C. § 78r(c), govern civil actions arising under Rule 10b-5?

OTHER PARTIES TO THE PROCEEDINGS IN THE NINTH CIRCUIT

In the proceedings below two actions were consolidated for appeal: *Mosesian v. Peat, Marwick, Mitchell & Co., et al.*, No. 83-5638, and *In re Charles L. Fletcher and Milton Fredman, as Co-Trustees of Royal Inns of America, Inc., a California corporation, and related entities, Lost Knight, Inc. and Jolly King Restaurants, Inc. v. Peat, Marwick, Mitchell & Co., partnership and Earl Gagosian*, No. 83-5639. Respondent Mosesian represents a class of shareholders in Royal Inns of America, Inc. There were no other parties to the proceedings in the Ninth Circuit.*

Petitioners only seek review of the Ninth Circuit's judgment in *Mosesian v. Peat, Marwick, Mitchell & Co.*

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* Several additional parties were dismissed or otherwise dropped from this action in the district court before the appeal was taken to the Ninth Circuit. They have no interest in this petition.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner Peat, Marwick, Mitchell & Co. ("PMM"), respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered on March 7, 1984.

PRIOR OPINIONS

The opinion of the Ninth Circuit is reported at 727 F.2d 873 and is printed in the Appendix at page C-1.

The order of the District Court for the Southern District of California (Nielsen, J.) is printed in the Appendix at page B-1.

JURISDICTION

The judgment of the Court of Appeals was entered on March 7, 1984. Petitioner sought rehearing, with a suggestion for rehearing *en banc*, on March 21, 1984, which was denied on June 7, 1984 (Appendix at D-1). The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional provision involved in this case is the Seventh Amendment, U.S. Const. Amend. VII. The statute involved is Section 18 of the Securities Exchange Act of 1934, 15 U.S.C. § 78r. Those provisions are set forth in the Appendix at A-1.

STATEMENT OF THE CASE

1. **Introduction.** This case presents a series of important and interrelated issues concerning the selection and application of statutes of limitation for use in connection with claims arising under section 10(b) of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder.

The law in this heavily litigated area* is currently unpredictable, lacking in uniformity and rife with opportunity for abuse. The limitations periods applied in 10b-5 actions range capriciously from one to ten years, depending on the law of the forum state, and—under the Ninth Circuit's ruling in this case—these grossly disparate periods can be extended virtually forever by a novel reading of "federal equitable tolling doctrine" which flies in the face of 105-year old Supreme Court precedent. The result is forum-shopping, deliberate delay for speculative purposes (*i.e.*, to determine whether a given investment will yield a gain or a loss) and, ultimately, the defeat of important policies underlying both statutes of limitation generally and the federal securities laws.

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* A rough count indicates that there are more than 300 *reported* cases involving statute of limitations issues in 10b-5 cases.

"Federal equitable tolling doctrine" is a broadly applied rule of federal decisional law which prevents statutes of limitation from running in fraud actions before the plaintiff, *despite* the exercise of due diligence, is able to discover the *facts* underlying his allegations of fraud.* The rule is designed to strike a balance—to avoid unfairness to putative fraud plaintiffs while, at the same time, giving adequate recognition to the need for repose and to other policies served by statutes of limitation. And the key to that balance is the 105-year old proposition that once plaintiff is on notice of facts sufficient "to excite attention and put [him] on his guard and call for inquiry," he must, with due diligence, investigate to determine whether he has a legal claim. *Wood v. Carpenter*, 101 U.S. 135, 141 (1879).

The court below has drastically upset that balance. As shown in Point I, *infra*, the novel version of "federal equitable tolling doctrine" enunciated by the Ninth Circuit in this case conflicts with the decisions of other federal courts of appeal and, if permitted to stand, would:

> (1) effectively "overrule" *Wood v. Carpenter*, thereby absolving fraud plaintiffs from any duty to be diligent in investigating and asserting their claims;
>
> (2) suspend the statute of limitations until plaintiffs discover not only the *facts* underlying their claims, but also the breach of *legal duty* ultimately alleged;
>
> (3) convert the statute of limitations into a device which, perversely, protects only the guilty and bars only meritorious claims; and

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* It should be noted that federal equitable tolling doctrine (which applies in cases involving "fraudulent concealment" of non-fraud claims as well as claims of "self-concealing" fraud) is not limited in its application to Rule 10b-5 actions. The Court has indicated that, where appropriate, this equitable doctrine is read into both federal statutes of limitation and state statutes "borrowed" by federal courts for use in federal causes of action. *Holmberg v. Armbrecht*, 327 U.S. 392, 396-97 (1946). *See also Moviecolor Ltd. v. Eastman Kodak Co.*, 288 F.2d 80, 84-85 (2d Cir.), *cert denied*, 368 U.S. 821 (1961) (antitrust action); *Baker v. F&F Investment*, 420 F.2d 1191, 1199 (7th Cir.), *cert. denied*, 400 U.S. 821 (1970) (civil rights claim); *Pruet Production Co. v. Ayles*, 573 F.Supp. 895 (S.D. Miss. 1983) (age discrimination action).

(4) put defendants accused of "fraud" to an unfair "election of defenses"—requiring them, as a practical matter, to choose between defending on the merits and defending on statute of limitations grounds.*

As shown in Point II below, the court of appeals' ruling that fraud plaintiffs are entitled to a jury trial on the applicability of federal equitable tolling doctrine (1) is contrary to Seventh Amendment law and (2) further defeats the essential purpose of the statute of limitations—*i.e.*, to protect defendants from defending stale claims after evidence has vanished and memories have grown dim. Under the court of appeals' decision (which makes it virtually impossible to resolve "tolling" issues as a matter of law) it will now be necessary to try even the most clearly time-barred 10b-5 cases before a jury in order to *decide* whether the statute should be tolled.

Finally, Point III demonstrates that the foregoing problems (and many others) could be avoided entirely if this Court were to overrule the current practice in the lower federal courts of borrowing the state statute of limitations applicable to the state cause of action most "analogous" to a Rule 10b-5 claim, and refer instead to the federal securities laws for the most analogous statute of limitations. This analogy would immediately achieve the uniformity and predictability which the law currently lacks in this area; and it would also give effect to Congress's obvious intention—expressed wherever Congress actually envisioned private civil remedies—that the applicable statute of limitations should be one year from discovery, *but in no event longer than three years*. That limitations period, which is both uniform and free from open-ended tolling doctrines, was specially tailored to the policies underlying the federal securities laws. To the very great extent that Rule 10b-5 has swallowed up the

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* The court below (although mischaracterizing PMM's argument) acknowledges the "Catch-22" situation which it has created:

> "Peat Marwick asserted that DCP was a generally accepted accounting practice at the time it prepared these statements, and it denies any wrongdoing. Nevertheless, it identifies seven "red flag" events which occurred in 1972 and 1973 and which it contends are sufficient as a matter of law to alert a reasonably prudent investor of wrongdoing on the part of Peat Marwick." (727 F.2d at 877) (App. C-6).

other civil remedies in those laws, those policies have been defeated by the current practice in the lower federal courts.*

As the Court has recently stated in *United States v. Kubrik*, 444 U.S. 111, 117 (1979):

> "Statutes of limitations, which 'are found and approved in all systems of enlightened jurisprudence' *Wood v. Carpenter*, 101 U.S. 135, 139, 25 L.Ed. 807 (1879), represent a pervasive legislative judgment that it is unjust to fail to put the adversary on notice to defend within a specified period of time and that 'the right to be free of stale claims in time comes to prevail over the right to prosecute them' . . . . These enactments are statutes of repose, and although affording plaintiffs what the legislature deems a reasonable time to present their claims, they protect defendants and courts from having to deal with cases in which the search for truth may be seriously impaired by the loss of evidence, whether by death or disappearance of witnesses, fading memories, disappearance of documents or otherwise."

The decision below defeats those salutary purposes. Each of the rulings challenged in this petition is wrong, not only as a matter of law, but also as a matter of policy and common sense. Taken together, they place an intolerable burden on petitioner, which, as an institutional, "deep pocket" 10b-5 defendant transacting business in virtually every state, is particularly vulnerable to the abuses they encourage. Petitioner urges the Court to grant certiorari and clarify and rationalize the law in this important area.

2. **Statement of Facts.**

a. *Background.* Royal Inns of America, Inc. ("RIA") was founded in 1965 by Earl Gagosian, who served as its chief executive

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* Of course, the Court has now established that the judicially-inferred Rule 10b-5 cause of action co-exists with overlapping express remedies in the securities laws (*Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983)); however, *Huddleston* leaves open (and, indeed, makes more important) the further question of what limitations should be placed upon that right to bring it generally into line with federal securities law policies. And other recent decisions of the Court (*see, e.g., DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151, 76 L.Ed. 2d 476, 485 & n.12 (1983)) suggest that, at least insofar as statutes of limitation are concerned, reference to analogous *federal* limitations periods may better advance the relevant federal policies than reference to state statutes of limitation.

officer until early 1973. RIA and its wholly-owned subsidiaries (including Jolly King Restaurants, Inc. and Lost Knight, Inc.) were engaged in the development, construction and operation, through joint ventures and limited partnerships, of a chain of "Royal Inns" motor hotels and associated "Jolly King" restaurants and "Lost Knight" cocktail lounges.

PMM examined and reported upon RIA's financial statements from 1967 through 1973. Between 1967 and 1971, RIA experienced rapid growth and significant earnings; however, in 1972, the company's financial health deteriorated sharply and, in 1975, RIA filed for bankruptcy.

b. *Procedural History*. This case was commenced as a class action on January 13, 1977 by Peter Mosesian ("Mosesian"), a stockholder of RIA. Asserting claims, *inter alia*, under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder, Mosesian challenged PMM's reports on the financial statements of RIA between 1967 and 1973.*

In essence, Mosesian claimed (as plaintiffs stated in their brief below) to have been misled into purchasing RIA stock by a "false image of growth and business prosperity." He claimed, among other things, that this "false image" of prosperity was created by the application of two accounting principles which, allegedly, PMM fraudulently reported as conforming to Generally Accepted Accounting Principles ("GAAP"). The application of those two accounting principles, which involved the reporting of "development and construction profit" and the supposed failure to reserve adequately with respect to certain receivables, allegedly inflated RIA's reported earnings and in turn the price of RIA's stock.

PMM asserted a statute of limitations defense. Mosesian countered that his claims had been preserved by federal equitable tolling doctrine because he had not "discovered" them until 1976, when RIA's trustee in bankruptcy issued a report which questioned the propriety of certain of RIA's accounting practices.

The district court then ordered a bifurcated trial, the first part of which was limited to the question of whether the statute of lim-

* The jurisdiction of the district court was based upon 15 U.S.C. § 78aa.

itations barred Mosesian's claims. PMM argued (1) that the statutory period set forth in Section 18(c) of the 1934 Act, 15 U.S.C. § 78r(c), should control Mosesian's 10b-5 claims and (2) that Mosesian had no Seventh Amendment right to a jury trial on the statute of limitations phase of the trial and that this phase should, therefore, be tried to the court. The trial court rejected both of these arguments. It concluded that California Code of Civil Procedure § 338(4) provided the governing statutory period,* and it impanelled a jury which was to hear both phases of the trial (assuming the merits phase were to become necessary).

At the ensuing trial before a jury, Mosesian directed his evidence toward showing that certain events, stipulated to by the parties, did not lead him—*directly*, *inevitably* and *without inquiry*—to his ultimate *legal* conclusion that PMM had committed the accounting fraud alleged. He presented no evidence that he had acted with diligence in light of facts which were publicly available to ascertain whether he had an actionable claim; indeed, the evidence showed that he exercised no diligence.

PMM argued at trial that no "accounting fraud" had occurred and that no facts—public or otherwise—could ever lead to any correct conclusion that it had. Nonetheless, PMM maintained that certain events (referred to by the parties as "red flag" events) put Mosesian on "inquiry notice" as a matter of law, and thereby placed him under a duty to investigate whether he had any legally cognizable claim. Because Mosesian failed to offer *any* proof tending to show that he had conducted a duly diligent inquiry (indeed, the evidence showed, and Mosesian conceded, the contrary), PMM contended that Mosesian had failed to meet his burden in the statute of limitations trial.**

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* Although both § 18(c) of the 1934 Act and § 338(4) of the California Code provide for a three year period, the three year period under § 18 constitutes the absolute maximum period without reference to federal equitable tolling doctrine. *See Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1308 (9th Cir. 1982); *LeCroy v. Dean Witter Reynolds, Inc.*, [Current] CCH Fed.Sec.L.Rep. ¶ 91,503 at 98,527 & n.3 (W.D.Ark. 1984) (construing similar language in 15 U.S.C. § 77m).

** Mosesian had the burden of proving facts warranting the tolling of the statute. *Wood v. Carpenter*, 101 U.S. 135, 141 (1879); *Vaughn v. Teledyne, Inc.*, 628 F.2d 1214, 1218 (9th Cir. 1980).

The jury concluded that Mosesian was not time-barred. The district court granted PMM judgment notwithstanding the verdict (App. B-1). The court of appeals reversed (App. C-1).

c. *Facts Constituting Inquiry Notice to Mosesian: The "Red Flag" Events.* It is undisputed* that the following catastrophic and widely publicized problems—each dramatically inconsistent with Mosesian's "false image" of RIA as a growing profitable company—befell RIA during the six-month period between October 1972 and April 1973:

> (i) *Sudden Enormous Losses.* Between 1967 and 1971, RIA had a consistent record of profitability, and Mosesian had been influenced by this fact before investing in the company. In 1972, however, that trend was suddenly reversed from a *$1.1 million profit in 1971 to a $1.8 million loss in 1972*. That reversal was fully reported in RIA's 1972 Annual Report and received widespread coverage in the press. As is clear from RIA's 1972 Annual Report, the most substantial change in RIA's earnings between 1971 and 1972 resulted from the fact that development and construction profit was 450% greater in 1971 than in 1972.
>
> (ii) *The "Going Concern" Qualification.* RIA's problems were so fundamental that PMM expressed a "going concern" qualification in its 1972 report on RIA's financial statements (published in RIA's 1972 Annual Report). It is uncontroverted that a "going concern" qualification, by definition, raises the question whether a company will stay in business and points out that a company has life-threatening financial problems.
>
> (iii) *Precipitous Decline in Stock Price.* Between January 28, 1972 and February 23, 1973, RIA's common stock (listed on the American Stock Exchange) lost almost 75% of its value, falling from $26.25 per share to $7.12 per share. During that same period, the American Index for all stock traded on the American Stock Exchange fell only 7.2%.
>
> (iv) *Suspension in Trading of RIA's Common Stock.* On February 26, 1973 trading in RIA's common stock was suspended on the American and Pacific Coast

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* In substance, all of these "red flag" events are set forth either in Part III (Admitted Facts) or in Part V (Uncontested Facts) of the Pre-Trial Order in this action. They are also recited by the Court of Appeals in its decision. (727 F.2d at 877-78) (App. C-6 to C-7).

stock exchanges. That event was publicly disclosed by RIA, and it also received substantial play in the press. Trading was never resumed.

(v) *RIA's Problems with Creditors.* RIA's inability to pay its creditors, in addition to being disclosed in RIA's 1972 Annual Report, received widespread publicity in early 1973, as did its retention of bankruptcy counsel at that time.

(vi) *Resignation of Earl Gagosian.* In March 1973, Earl Gagosian, founder of RIA, resigned as chief executive officer, and a month later he resigned as chairman of the board. Those events were publicly announced by RIA and also discussed in the press.

(vii) *The Serpa Complaint.* On October 12, 1972, a class action lawsuit entitled *Serpa v. Jolly King Restaurants, Inc., et al.*, Civ. No. 72-423-N, was filed in United States District Court for the Southern District of California. The *Serpa* complaint alleged that Royal Inns and its subsidiaries had engaged in securities fraud as well as fraud in their accounting methods. The case was disclosed by RIA in a number of public documents, and PMM qualified its 1972 Report because of it. Moreover, the case received substantial play in the press.

Mosesian acknowledged below that he had made no investigation at all in light of these "red flag" events. He argued instead that he was not required to, because, as he stated in his brief, none of the "red flag" events led him to believe that "Royal Inns' earnings had been improperly inflated through the reporting of development and construction profit, that the asset value of receivable categories on the balance sheet were [sic] artificially high, or that Peat Marwick was in any way involved in improper income reporting or asset valuation."

3. **The Court of Appeals' Decision.** Although the court of appeals' opinion is rife with confusion about precisely what it is that must be "discovered" before the statute begins to run,* its basic

* The opinion refers variously to discovery of "the fraud" (727 F.2d at 877), "fraudulent conduct" (*id.*), "the alleged wrongdoing" *(id.)*, "accounting fraud" (*id.* at 878), "fraud or other misconduct" (*id.* at 879), and the correctness or incorrectness of "Peat Marwick's accounting and auditing procedures" *(id.)* (App. C-6 to C-9). Obviously, these "standards" are not synonymous and can have very different consequences in decisions as to whether the statute should be tolled.

holding is that because the "red flag" events, *supra*, "do not *necessarily* suggest *accounting fraud*" —*i.e.*, because those events "may also be explained by . . . events unrelated to accounting fraud" (727 F.2d at 878) (App. C-8)—Mosesian was not obliged to make any inquiry into whether he had a legally cognizable claim, and the jury was entitled to conclude that the statute was tolled.

The court of appeals also held that Section 18(c) of the 1934 Act did not provide the controlling limitations period, and that Mosesian was "entitled" to a jury trial on tolling issues—even in the first phase of a bifurcated trial limited to the question of whether the statute of limitations should be tolled (*id.* at 876, nn.4&5) (App. C-4 to C-5, nn.4&5).

REASONS FOR GRANTING THE WRIT

I. THE NINTH CIRCUIT'S DECISION ON FEDERAL EQUITABLE TOLLING DOCTRINE CONFLICTS BOTH WITH THE APPLICABLE DECISIONS OF THE COURT AND DECISIONS OF COURTS OF APPEAL.

A. The Decision Below Is Contrary to Prevailing Law.

1. *The Decision Below Effectively "Overrules" the Controlling Decisions of the Court.* "Federal equitable tolling doctrine" was first adopted by the Court in *Bailey v. Glover*, 88 U.S. 342 (1875), where it was held that, in actions grounded in fraud, the statute of limitations would not run until the plaintiff—without "negligence or laches" on his part—had "discovered" his claim.

Four years later, in *Wood v. Carpenter*, 101 U.S. 135 (1879), the Court added an important clarification, holding that notice of certain types of facts places a putative fraud plaintiff under a duty to inquire. The Court, in *Wood*, established the following standard for "inquiry notice":

> " '*Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of everything to which such inquiry might have led. When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it.*' " 101 U.S. at 141 (Emphasis added).

That principle remains viable today. Accordingly, it has long been recognized in 10b-5 actions that

> "*What on the one hand is tantamount to an actual discovery of fraud should not be confused with what on the other carries a duty to investigate*. It is impossible to lay down any general rule as to the amount of evidence or number or nature of evidential facts admitting discovery of fraud. *But, facts in the sense of indisputable proof or any proof at all, are different from facts calculated to excite inquiry which impose a duty of reasonable diligence and which, if pursued, would disclose the fraud.*"* (Emphasis added).

In a related area, the Court has recently held that once a person injured by medical malpractice (which, like fraud, is often "self-concealing") is aware (1) of his injury and (2) of its possible cause, the statute will begin to run. *United States v. Kubrik*, 444 U.S. 111, 122-25 (1979). In *Kubrik*, the Court squarely rejected the argument that the statute is tolled until a putative plaintiff becomes aware that his injury stemmed from defendant's *breach of a legal duty*. Rather, such a plaintiff has a duty to inquire, which includes a duty to consult with experts to ascertain if he has a legal claim (*id.* at 123):

> "A plaintiff . . . armed with the facts about the harm done to him, can protect himself by seeking advice in the medical and legal community. To excuse him from promptly doing so . . . would undermine the purpose of the limitations statute . . . ."

The Court concluded (*id.* at 125):

> "We also have difficulty ascertaining the precise standard proposed by the District Court and the Court of Appeals. On the one hand, the Court of Appeals seemed to hold that a . . . malpractice claim would not accrue until the plaintiff knew or could reasonably be expected to know of the . . . breach of duty. Ibid. On the other hand, it seemed

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* *Tobacco & Allied Stocks v. Transamerica Corp.*, 143 F. Supp. 323, 331 (D. Del. 1956), *aff'd*, 244 F.2d 902 (3d Cir. 1957). *See also Cook v. Avien, Inc.*, 573 F.2d 685, 697 n.25 (1st Cir. 1978); *de Haas v. Empire Petroleum Co.*, 435 F.2d 1223, 1226 (10th Cir. 1970); *Sleeper v. Kidder Peabody & Co.*, 480 F. Supp. 1264, 1267 (D. Mass. 1979), *aff'd*, 627 F.2d 1088 (1st Cir. 1980); *Natural Resources Corp. v. Royal Resources Corp.*, 427 F. Supp. 880, 888 (S.D.N.Y. 1977).

> to hold that the claim would accrue only when the plaintiff had reason to suspect or was aware of facts that would have alerted a reasonable person to the possibility that a legal duty to him had been breached. Ibid. *In any event, either of these standards would go far to eliminate the statute of limitations as a defense separate from the denial of breach of duty.*" (Emphasis added).*

These cases clearly establish, and the federal courts have (until the decision below) generally adhered to, a *two-step* test. The first analytical step is to determine whether plaintiff is on *notice* of facts sufficient to place him under a duty of inquiry; the second is whether, *upon diligent inquiry*, he could have discovered the facts alleged to constitute a breach of legal duty—in 10b-5 cases, "fraud." The issue at the first step (the "inquiry notice" step) is that set forth in *Wood*—*i.e.*, whether plaintiff was or should have been aware of facts sufficient "to excite attention and put the party on his guard and call for inquiry" (*Wood v. Carpenter, supra*, 101 U.S. at 141).

Although courts have stated that threshold test in a variety of ways, it is clear that the quantum of fact constituting "inquiry notice" is *not* (and, logically, cannot be) tantamount to facts which "necessarily" indicate "fraud."** If it were, there would be no need for further "inquiry." However, the court below ignored the threshold "inquiry notice" test of *Wood v. Carpenter* and the proposition, established in *Kubrik*, that the statute of limitations does not await plaintiff's knowledge that a legal duty has been breached. Rather, it held that unless Mosesian was confronted with facts which "*necessarily* suggest *accounting fraud*"—facts which cannot "be explained by . . . events unrelated to accounting fraud"—the statute of limitations could not begin to run in favor of PMM as a matter of law (727 F.2d at 878) (App. C-8). That standard completely eliminates the duty of diligent inquiry required in *Wood;* and as the Court

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* *Kubrik* involved the Federal Tort Claims Act. The Fifth Circuit, however, has recently concluded that it represents a more general statement of the discovery rule, applicable in a variety of federal cases. *Dubose v. Kansas City Southern Ry. Co.*, 729 F.2d 1026, 1029-30 (5th Cir. 1984).

** *Tobacco & Allied Stocks v. Transamerica Corp., supra*, 143 F. Supp. at 331. As one court has rephrased the test, the question is whether plaintiff was on notice of facts sufficient to show that "something was amiss." *Hupp v. Gray*, 500 F.2d 993, 996-97 (7th Cir. 1974).

noted in *Kubrik*, it goes far to "eliminate the statute of limitations as a defense separate from the denial of a breach of duty" (444 U.S. at 125).

2. *The Ninth Circuit's Decision Conflicts With the Decisions of Other Courts of Appeal.* As already shown, it was undisputed below that, by early 1973, seven discrete "red flag" facts—all flatly inconsistent with Mosesian's view of RIA as prosperous and growing—were either actually known by Mosesian or publicly available to him.

In other federal courts and courts of appeal, such "red flag" events (usually fewer in number) have been held, either alone or in combination with other events, to establish *inquiry notice* as a matter of law. These include:

(1) a precipitous decline in stock price;*

(2) a stop in stock trading;**

(3) a drastic reversal in profitability;***

(4) announced problems with creditors;†

(5) other lawsuits;†† and

(6) reorganization of top management.†††

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* *See, e.g., Hupp v. Gray*, 500 F.2d 993, 996-97 (7th Cir. 1974); *Cook v. Avien, Inc.*, 573 F.2d 685, 696 (1st Cir. 1978); *Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402, 410 (2d Cir. 1975).

** *See, e.g., Cook v. Avien, Inc., supra*, 573 F.2d at 696; *Gluck v. Amicor, Inc.*, 487 F. Supp. 608, 614 (S.D.N.Y. 1980); *Daniels v. Ernst & Ernst* [1976-77 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,871 at 91,205-06 (S.D.N.Y. 1977).

*** *See, e.g., Cook v. Avien, Inc., supra*, 573 F.2d at 696; *Buder v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 644 F.2d 690, 693 (8th Cir. 1981); *Seiffer v. Topsy's International, Inc.*, 487 F. Supp. 653, 705-06 (D. Kan. 1980).

† *See, e.g., Arneil v. Ramsey*, 550 F.2d 774, 781 (2d Cir. 1977); *Gaudin v. KDI Corp.*, 576 F.2d 708, 712 (6th Cir. 1978); *Daniels v. Ernst & Ernst, supra*, at 92,205-06.

†† *See, e.g., Berry Petroleum Co. v. Adams & Peck*, 518 F.2d at 410; *Gaudin v. KDI Corp., supra*, 576 F.2d at 712; *Daniels v. Ernst & Ernst, supra*, at 91,206.

††† *Daniels v. Ernst & Ernst, supra*, at 92,206.

Moreover, it is hard to imagine any brighter "red flag"—to one who invested in RIA stock on the basis of a belief that RIA would grow and prosper—than an accountants' report, received shortly thereafter, that contains disclosure of critical financial problems and contingencies, including the following "going concern" qualification:

> "The accompanying financial statements have been prepared in conformity with generally accepted accounting principles which contemplate the continuation of the Company as a going concern. As set forth in note 3, the Company has experienced financial difficulties and is presently working with its creditors to develop a plan for payment of creditors' claims in an orderly fashion and is also attempting to obtain additional financing. In addition, certain conditions have occurred since December 31, 1972 which are considered 'events of default' under the agreement relating to the Company's $4 million bank loan. However, the bank has not declared the note immediately due and payable. *Continuation of the Company as a going concern is dependent upon obtaining additional financing and negotiating satisfactory arrangements with the bank and creditors.*" (Emphasis added).

Petitioner freely concedes—and, indeed, affirmatively asserts—that the "red flag" events do not "*necessarily*" lead to the conclusion that particular line items in RIA's financials were "fraudulently" reported. They could not possibly, because there is no fraud in this case. However, those events do (as the numerous cases cited above hold) place a 10b-5 plaintiff on *inquiry notice* as a matter of law; they are facts which "excite attention and put [one] on his guard and call for inquiry". *Wood v. Carpenter, supra,* 101 U.S. at 141. To do nothing in the face of such facts is to lose one's claim.

To demonstrate the nature of the conflict which the Ninth Circuit's decision in this case has engendered, it is helpful to consider in greater detail the facts of some of the cases from other circuits cited above. As one might expect, the application of the Ninth Circuit's test in those cases would lead to dramatically different results:

a. In *Hupp v. Gray,* 500 F.2d 993 (7th Cir. 1974), plaintiff purchased shares relying on statements, *inter alia,* that they "might"

go from $47 (the purchase price) to $75 per share "at an early date" (*id.* at 996). Within slightly more than a year, the stock fell to $17.50 per share. The court held, as a matter of law, that this was sufficient to place plaintiff on "inquiry notice"—"although [plaintiff] had notice that something was amiss and ample opportunity to investigate, he did nothing" (*id.*, at 997).*

b. In *Buder v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 644 F.2d 690 (8th Cir. 1981), plaintiffs were told by Merrill Lynch that Real Estate Investment Trust ("REIT") securities were "sound securities, promising high yields and growth possibilities with little attendant risk" (*id.* at 692). Subsequently, plaintiffs received Merrill Lynch research reports stating that REIT investments were risky and annual reports from certain REIT's showing "sharp declines in market prices, book values, earnings and dividends" (*id.* at 693). The court—affirming the district court's grant of summary judgment for Merrill Lynch—held that these "facts were such as to 'excite inquiry' " (*id.* at 693).**

c. In *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978), plaintiffs had been "led to believe that Avien had a 'rosy' future; some had been assured that they would double their money in a short while" (*id.* at 695). Subsequently, they learned that (1) the company was suffering substantial losses (in contrast to substantial profits in the preceding year); (2) the stock had declined and finally stopped trading; and (3) Avien's accountants had refused to certify certain financial reports (*id.* at 695-96). The court held these events constituted "inquiry notice" (*id.* at 696).

d. In *Arneil v. Ramsey*, 550 F.2d 774 (2d Cir. 1977), plaintiffs had invested in Blair & Co. in reliance on advertising that it was in fine financial shape and would be an excellent growth investment (*id.* at 781). Five months later, in August 1969, a firm which it had recently acquired publicly admitted securities law violations (but not

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* *See also Gieringer v. Silverman*, 731 F.2d 1272, 1278-81 (7th Cir. 1984) (knowledge that offering price is inadequate places plaintiff on inquiry notice and starts statute running; *Hupp v. Gray* cited with approval); *Morgan v. Koch*, 419 F.2d 993 (7th Cir. 1969).

** *See also Koke v. Stifel, Nicolaus & Co., Inc.*, 620 F.2d 1340 (8th Cir. 1980) (confirmation slips showing losses sufficient to place plaintiff on inquiry notice; summary judgment affirmed).

vis-a-vis plaintiffs); in March 1970, Blair informed its stockholders of the "absence of any book value" for its stock (*id.* at 777); in August 1970, Blair terminated its public business (*id.*); and in September 1970, an involuntary petition in bankruptcy was filed (*id.*). The court affirmed summary judgment, holding that, plaintiffs were barred because they knew of the "extremely critical nature of Blair's problems" but failed to seek out the facts underlying their claims (*id.* at 781).*

In all of these cases, from four federal circuits,** "inquiry notice" was held to arise from the *inconsistency* between what the putative plaintiff had been told and what he had subsequently learned to be the fact. However, the facts which come to light need not "necessarily" lead directly to the legal conclusion that a "fraud" has occurred. They need only, *in general terms*, be inconsistent with the state of facts that plaintiff relied upon in investing, and suggest that "something [is] amiss." *Hupp v. Gray*, *supra*, 500 F.2d at 997.

In the present case, Mosesian alleges that he invested on the strength of the "rosy picture" of RIA which he claims was portrayed in RIA's annual reports and its financials (reported on by PMM). It is beyond dispute that Mosesian knew, by early 1973, that this previously perceived portrayal of RIA was contrary to new facts and that he had suffered a financial loss as a result. Under all of the cases cited above, and under the controlling decisions of the Court, that is more than enough to place Mosesian under a duty to inquire as a matter of law.

What Mosesian did not know, and could not, as a layman, have possibly ascertained without the advice of a lawyer or an accountant, was whether RIA's financials were reported in conformity with Generally Accepted Accounting Principles ("GAAP"). That is a technical issue which can only be resolved by applying GAAP to the facts and drawing an "expert" conclusion. Similarly, the plaintiff in *Kubrik*, *supra*, could not have ascertained, without consulting a

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* *See also Berry Petroleum Co. v. Adams & Peck*, 518 F.2d 402 (2d Cir. 1975).

** For other results inconsistent with the decision below, see *Vance v. National Realty Trust*, [1975 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 95,004 (D.C. Cir. 1975); *Gaudin v. KDI Corp.*, 576 F.2d 708 (6th Cir. 1978).

doctor, whether his previous treatment had conformed to generally accepted medical standards. But that did not absolve him from inquiring:

> "A plaintiff such as Kubrik, armed with the facts about the harm done to him, can protect himself by seeking advice in the medical and legal community. To excuse him from promptly doing so by postponing the accrual of his claim would undermine the purpose of the limitations statute, which is to require reasonably diligent presentation of tort claims . . . ." (444 U.S. at 123).*

The Ninth Circuit's decision is similarly subversive. Far from requiring Mosesian to seek professional advice in determining whether he had legal redress for his injury, the court below stated that Mosesian had no obligation to do anything at all until events or circumstances arise which can have no explanation other than "accounting fraud." Since the question of whether an "accounting fraud" has occurred at all is the ultimate issue in cases such as the present, the statute can never run, under the Ninth Circuit's test, until such a case is decided on the merits.

B. The Ninth Circuit's Decision Protects Only the Guilty.

The inescapable practical consequence of the panel's decision is that, if facts must exist which can only be "explained" by "accounting fraud" (727 F.2d at 878) (App. C-8), then the statute cannot run in favor of an accountant who has *not*, in fact, committed "accounting fraud." Accordingly, while the statute may bar litigation of meritorious claims (indeed, the more flagrant the fraud the more likely it will be barred), it will *never* run where, as here, no "fraud" has occurred. Thus, the perverse rule framed by the panel will protect defendants truly guilty of fraud while preserving forever meritless claims (such as those in the present case) against innocent defendants.

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* At least two circuits have held that this is also the rule in 10b-5 actions. *Vigman v. Community National Bank & Trust Co.*, 635 F.2d 455, 459 (5th Cir. 1981); *Goldstandt v. Bear Stearns & Co.*, 522 F.2d 1265, 1269 (7th Cir. 1975).

C. The Statute Can No Longer Run in "Accounting Fraud" Cases.

Under the present decision, the statute will almost never run as a matter of law in "accounting fraud" cases. It is hard to imagine a case in which a greater array of "red flag" events, putting plaintiffs on inquiry notice, could be assembled. Yet because of the nature of "accounting fraud"—which almost always involves technical issues—objective phenomena (*e.g.*, the failure of a company, suspension of trading, etc.) are unlikely "necessarily" to point to "accounting fraud." Alternative explanations will always be available; indeed, they were available in each of the cases cited above. Thus, short of a public confession by a fraud defendant or perhaps the filing of a complaint alleging *precisely* the same "fraud" subsequently alleged against *precisely* the same parties,* the statute of limitations could virtually never be held to have run as a matter of law.

D. The Ninth Circuit's Decision Puts Defendants Charged With "Fraud" to an "Election of Defenses."

Finally, not only will the Ninth Circuit's decision preserve non-meritorious fraud claims forever, but, as a practical matter, it will make assertion of a statute of limitations defense impossible even after such claims are finally brought. At trial (and there will always be a jury trial on these issues under the Ninth Circuit's erroneous rulings), defendants accused of fraud will be put to a "Hobson's choice" of arguing either (a) that the statute has run because facts "necessarily" indicative of "fraud" placed plaintiff on notice or (b) that no fraud occurred, thus effectively waiving their statute of limitations defense. Obviously, defendants cannot, as a practical matter, argue to the jury that the *same facts* both do and do not show "fraud." And since no innocent defendant in his right mind will concede fraud in order to set up a statute of limitations defense, the effect of this decision is to repeal the statute, at least with respect to innocent "fraud" defendants.

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* The panel concluded that the *Serpa* complaint against Royal Inns (which included allegations of securities fraud resulting, in part, from Royal Inns' bookkeeping) did not "necessarily" suggest accounting fraud (727 F.2d at 878-79) (App. C-9).

E. Conclusion.

The two-stage test adopted in *Wood v. Carpenter* has survived for 105 years because it makes sense. It enables a defendant accused of fraud to assert the defense of the statute of limitations without conceding guilt; it permits the statute to protect innocent parties; it places upon fraud plaintiffs an obligation to be diligent in investigating and pressing their claims; and, in general, it strikes a balance between the policies underlying statutes of limitation and those intended to deter and punish fraud.

The Ninth Circuit's decision destroys that balance. Under its ruling, the statute now cannot run until facts which "necessarily" lead to a conclusion of "fraud" by a particular defendant appear in the public domain. No inquiry—diligent or otherwise—is required. And, as a practical matter, this decision prevents the statute from ever running in cases which, like the present, involve allegations of technical "accounting fraud." The rule is contrary to controlling precedent, it defeats the purposes of statutes of limitation without advancing the goal of deterring fraud, and it is fundamentally unfair by punishing the innocent while rewarding the guilty.

II. THE COURT SHOULD RESOLVE THE IMPORTANT CONSTITUTIONAL QUESTION OF WHETHER THE SEVENTH AMENDMENT PROVIDES A RIGHT TO A JURY TRIAL ON THE APPLICABILITY OF FEDERAL EQUITABLE TOLLING DOCTRINE.

The Ninth Circuit's decision that plaintiffs were entitled to a jury trial on the applicability of federal equitable tolling doctrine is wrong both as a matter of Seventh Amendment law and as a matter of policy. Because of the widespread use of federal equitable tolling doctrine, and because of the potential for inefficiency and jury confusion inherent in the decision below, the Court should grant certiorari.

A. There Is No Seventh Amendment Right to a Jury for Purposes of Determining the Applicability of Federal Equitable Tolling Doctrine.

It is axiomatic that "[t]he Seventh Amendment creates no right of trial by jury." 5 J. Moore, *Federal Practice* ¶ 38.08 [5.-6] at

38-55 (1982). Rather, as the Court has repeatedly stated, "the thrust of the [Seventh] Amendment was to *preserve* the right to jury trial as it existed in 1791."* Accordingly, the primary inquiry, in determining the existence *vel non* of a right to a jury trial with respect to a given issue is historical—*i.e.* whether, at the time the Seventh Amendment was enacted, that issue fell within the jurisdiction of "law" or "equity."

1. *Pre-1791 Practice.* The Tenth Circuit, in *State of Ohio* v. *Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 692-93 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981), has recently reviewed the origins and evolution of federal tolling doctrine and arrived at the following conclusion:

> "Early English statutes of limitation provided that 'no person shall sue, have or maintain any writ' after a specified time. 32 Hen. VIII c.2 (1540). Since the statute did not apply to chancery, however, a party with no remedy at law because of the statutory bar could sue out a bill in equity. But to win the chancellor's favor, the suitor would have to show by clear and convincing proof that he had been diligent and faultless in pursuit of his rights. Thus the U.S. Supreme Court, in announcing that the limitation provision of the federal bankruptcy statute could be tolled by a federal judge on equitable grounds, made clear that tolling could occur only where plaintiff's delay was without 'fault,' 'want of diligence or care,' 'negligence' or 'laches'. *Bailey v. Glover* [88 U.S. 342, 349-50 (1875)]. In equity the issue of diligence was decided by the chancellor often on written peti-

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* *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 333 (1979) (emphasis added); *Atlas Roofing Co., Inc. v. OSHA*, 430 U.S. 442, 459 (1977); *Curtis v. Loether*, 415 U.S. 189, 193 (1974); *Pernell v. Southall Realty*, 416 U.S. 363, 374-76 (1974). *See also Ross v. Bernhard*, 396 U.S. 531, 543 (1970) ("All agree that . . . the Amendment is limited to those actions that were tried to the jury in 1791 when the Amendment was adopted") (Stewart, J., dissenting).

> tions as opposed to live testimony—a procedure much like our summary judgment under Fed. R. Civ. P. Rule 56."*

As the foregoing suggests, early chancery cases developed the rule that in an equitable action for relief from fraud, the operation of the statute could be postponed until discovery. *Booth v. Lord Warrington*, 2 Eng. Rep. 111 (1714); *South Sea Co. v. Wymondsell*, 24 Eng. Rep. 1004 (1732). At law, however, the command of the statute was absolute, and tolling was not available. As one English court stated the rule in 1836:

> "The statute [of limitations] does not absolutely bind Courts of equity, but they adopt it as a rule to assist their discretion. In cases of fraud, however, they hold that the statute runs from the discovery, because the laches of the plaintiff commences from that date. . . . In this, Courts of equity differ from Courts of law, which are absolutely bound by the words of the statute." *Brooksbank v Smith*, 2 Younge & Coll. 58, 60 (1836).

This appears to have been the general rule in England at the time of the adoption of the Seventh Amendment.**

2. *Equity Jurisdiction*. The classic statement of the distinction between law and equity jurisdiction is as follows:

> "[T]he jurisdiction [of a court of equity], when it assumes a power of decision, is to be exercised, 1. where the

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* *See also* J. Story, *Equity Jurisprudence* §§ 1971, 1974, 1975 (1918 ed.); Dawson, *Undiscovered Fraud and Statutes of Limitation*, 31 Mich.L.Rev. 591, 597 (1933):

> "The statute of James I [a statute of limitations—21 James I, c.16, sec.7, 7 Stats. at Large 275 (1623)] . . . contained no exception for cases of fraud. . . . But bills in equity were not included in the enumeration of actions barred by the statute of James. The Chancery was thus left free to formulate, under the cloak of its own doctrine of laches, independent tests for equitable remedies."

** The phrase "common law", as used in the Seventh Amendment, refers to "the common law of England, the grand reservoir of all our jurisprudence." *United States v. Wonson*, 28 Fed. Cas. 745, 750 (C.C.D. Mass. 1812) (Story, J.). Reference to the practice in the various states with respect to jury trials was not possible due to the wide variations in that practice among the states. *Colgrove v. Battin*, 413 U.S. 149, 153-54 (1973); 5 J. Moore, *Federal Practice* ¶ 38.08 [5.-1] at 38-38 to 38-39, ¶ 38.08 [5.-4] at 38-48 (1982).

> principles of law by which the ordinary courts are guided give a right, but the powers of those courts are not sufficient to afford a complete remedy, or their modes of proceeding are inadequate to the purpose; 2. where the courts of ordinary jurisdiction are made instruments of injustice; 3. where the principles of law by which the ordinary courts are guided give no right, but upon the principles of universal justice the interference of the judicial power is necessary to prevent a wrong, and the positive law is silent. . . ."*

Applying this test—formulated in 1787—it is clear that the remedy sought by the invocation of equitable tolling doctrine falls squarely within equity jurisdiction. Although "principles of law" (*i.e.*, statutes) provide for a limitations defense, that defense, if strictly applied, could become an instrument of injustice; indeed, it is this possibility that gave rise to equitable tolling doctrine in the first place. As stated in J. Story, *Equity Jurisprudence* § 1974 (1918 ed.):

> "Courts of Equity ... interfere in many cases to prevent the bar of the statutes [of limitation] where it would be inequitable or unjust. Thus, for example, if a party has perpetrated a fraud which has not been discovered until the statutable bar may apply to it at law, Courts of Equity will interpose and remove the bar out of the way of the other injured party. A fortiori they will not allow such a bar to prevail by mere analogy to suits in equity, where it would be in furtherance of a manifest injustice."**

There can thus be no doubt that the federal equitable tolling doctrine is the outgrowth of a rule of equity; there was no "right" to

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* J. Mitford, *A Treatise on the Pleadings in Suits in the Court of Chancery by English Bill* 103-04 (2d ed. 1787). *See also* Devlin, *Jury Trial of Complex Cases: English Practice at the Time of the Seventh Amendment*, 80 Colum. L. Rev. 43, 51-52 (1980).

** *See also* H. G. Wood, *Limitation of Actions*, § 275 at 1365 (1916 ed.) (a court of equity will not allow the statute to run in cases of undiscovered fraud, because "it ought not in conscience to run; the conscience of the party being so affected that he ought not to be allowed to avail himself of the length of time"); *Brooksbank v. Smith*, 2 Younge & Coll. 58, 60 (1836) ("statute [in equity] runs from discovery, because the laches of the plaintiff commences from that date").

a jury trial on the appropriateness of applying the doctrine in 1791; and, accordingly, there is no such right for the Seventh Amendment to "preserve."

B. The Ninth Circuit's Decision Invites Jury Confusion and Judicial Inefficiency.

In *Ross v. Bernhard*, 396 U.S. 531, 538 n.10 (1970), the Court has suggested that, in addition to historical considerations, it may be appropriate also to consider the "practical abilities and limitations of juries" in arriving at a determination as to whether an issue should be tried to a jury or to the court.

Such considerations provide yet another reason why juries should not, as a practical matter, be called upon to rule on the applicability of federal equitable tolling doctrine; and that is particularly true if the tolling standard created by the Ninth Circuit in this case should be upheld. Operating under that erroneous standard, a defendant charged with fraud is in the impossible position of arguing before the same jury that the facts "necessarily" demonstrate "fraud" (and, therefore, should have led to its discovery at an earlier time), but that he is, nonetheless, innocent of fraud (*see* Point I.D. *supra*). These positions are mutually exclusive.

Even under the correct tolling standard, trying both tolling and "merits" issues before the same jury invites confusion. A judge can understand that something may have been "amiss," *Hupp* v. *Gray*, 500 F.2d 993, 997 (7th Cir. 1974), and, therefore, that the plaintiff was on notice to inquire under *Wood v. Carpenter*, *supra*; he can also understand, following such inquiry, that the defendant may be blameless. Most juries would have difficulty making that distinction.

Finally, it is preferable, as a matter of judicial administration to allocate this threshold collateral issue to the court. It has long been recognized that no jury trial right exists as to disputed fact questions arising in connection with similar preliminary, collateral issues such as personal jurisdiction, subject matter jurisdiction and venue. 5 J. Moore, *supra*, ¶38.36 [1] to [2.-3]. Professor Moore has observed, in connection with this rule:

> "[I]t is important that the collateral issues be determined prior to trial on the merits, as a usual proposition; and

> speedily. To extend jury trial of these issues as a matter of right would result in delay and thereby impair the substantial right of jury trial on the merits—surely the great objective of the Seventh Amendment" (*id.* at 38-313).

The Ninth Circuit's unwarranted extension of the right to a jury trial to tolling issues is similarly subversive of judicial efficiency and creates a threat of jury confusion.

III. THE COURT SHOULD RESOLVE THE IMPORTANT FEDERAL QUESTION OF WHETHER SECTION 18(c) OF THE 1934 ACT PROVIDES THE STATUTORY PERIOD IN RULE 10b-5 ACTIONS.

The 1934 Act does not provide a limitations period for private actions arising under Section 10(b), and the lower federal courts have accordingly adopted and applied (on an *ad hoc* basis) state statutes which they deem to apply to "analogous" state causes of action. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n.29 (1976); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 74 L. Ed. 2d 548, 556-57 n.18 (1983). As a result, 10b-5 actions are currently governed by a patchwork quilt of statutory periods ranging from as little as one to as many as 10 years,* and the availability of these dramatically different time periods encourages forum shopping,** securities speculation and tactical delay.

These problems can be readily avoided by the use, in 10b-5 actions, of the limitations period set forth in Section 18(c) of the 1934 Act, 15 U.S.C. § 78r(c). Virtually every commentator to consider the question has concluded, along with Professor Louis Loss, that it is "eminently more consistent with the overall statutory

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* 5C A.S. Jacobs, *Litigation and Practice Under Rule 10b-5* § 235.02 at 10-20 to 10-26 (1984).

** This abuse is particularly pervasive as a result of the broad venue provisions of the 1934 Act. The Act provides that causes of action may be brought in the district "wherein any act or transaction constituting the violation occurred" or in the district "wherein the defendant is found or is an inhabitant or transacts business. . . ." 15 U.S.C. § 78aa. Because PMM transacts business in virtually every state, it can theoretically be sued almost anywhere. Similarly, a large corporation that is traded publicly and does business in many states can be subject to suit in many districts.

scheme [of the federal securities laws] to look to what Congress itself did when it was thinking specifically of private actions in securities cases rather than to a grab bag of more or less analogous state statutes." 6 L. Loss, *Securities Regulation* at 3899-3900 (1969 Supp.).*

It is, of course, now clear that where Congress has failed to provide a statute of limitations, the federal courts should apply the statute of limitations—state or federal—which best effectuates the relevant *federal* policy. *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151, 76 L.Ed. 2d 476, 485 & n.12 (1983).** And a number of federal courts have acknowledged that Section 18(c) (and its counterparts in the federal securities laws) provide an analogy far better suited than any state statute to effectuate the *federal* policies underlying those laws. The Fifth Circuit has stated, in *McNeal v. Paine, Webber, Jackson & Curtis, Inc.*, 598 F.2d 888, 891-92 (1979):

> "We are . . . compelled [by precedent] to apply [the state statute of limitations] rather than follow the logically more appealing course of applying the period of limitations applicable to a similar cause of action expressly provided in the federal securities laws. Although the latter approach would lead to desirable uniformity in securities litigation from state to state and would eliminate the need to engage in difficult and essentially esoteric comparisons of federal and state remedies, reform must await congressional action."

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* *See also* Martin, *Statutes of Limitations in 10b-5 Actions: Which State Statute is Applicable*, 29 Bus. Law. 443, 457 (1974) (present state of law a "dismal failure"); Israels, *Book Review*, 77 Yale L.J. 1591-92 (1968); Bateman & Keith, *Statutes of Limitations Applicable to Private Actions Under SEC Rule 10b-5: Complexity in Need of Reform*, 39 U.Mo.L.Rev. 165 (1974); Schulman, *Statutes of Limitation in 10b-5 Actions: Complication Added to Confusion*, 13 Wayne L. Rev. 635 (1967).

** *See also Occidental Life Insurance Co. v. EEOC*, 432 U.S. 355, 367 (1977) ("State legislatures do not devise their limitations periods with national interests in mind, and it is the duty of the federal courts to assure that the importation of state law will not frustrate . . . national policies"); *McAllister v. Magnolia Petroleum Co.*, 357 U.S. 221 (1958). *Cf. United Parcel Service v. Mitchell*, 451 U.S. 56, 68 n. 4 (1981) (Stewart, J., concurring) (where cause of action is judicially inferred, it is particularly appropriate for federal court to draw on federal statute of limitations governing a related form of relief in the same statutory scheme).

Similarly, the Sixth Circuit, in *Nickels v. Koehler Management Corp.*, 541 F.2d 611, 614 (1976), *cert. denied*, 429 U.S. 1074 (1977) (McCree, J.), has stated:

> "Although a uniform federal period of limitation would prevent the anomaly of applying different limitations periods to plaintiffs who purchased or sold the same security but resided in different states, a single circuit cannot impose a pattern on the entire nation . . . . Accordingly, at this late hour only the Congress or the Supreme Court can impose uniformity."*

The controlling federal policy in this area is not obscure. A review of the 1934 Act and the Securities Act of 1933 ("1933 Act"), demonstrates that Congress—where it expressly created civil liabilities (and, therefore, considered the limitations question)—was extremely consistent in its approach. Sections 11(a), 12(1) and 12(2) of the 1933 Act (15 U.S.C. §§ 77k(a), 77*l*(1) and 77*l*(2)) and sections 9, 18 and 29 of the 1934 Act (15 U.S.C. §§ 78i, 78r and 78cc) are all governed by the same basic period—one year from discovery of the wrong, with a maximum limitation of three years from the time of wrong.**

That formulation reflects a clear legislative judgment (1) that a *uniform* statutory period should apply nationally to govern civil liabilities arising under the federal securities laws and (2) that the period involved should *contain an outside maximum*, free of open-ended "tolling" doctrines. As one commentator has noted:

> "Short statutes of limitations with an outside cut-off date are particularly appropriate in the case of securities or other fungibles of fluctuating value. Otherwise a party could sit back and, within the allowable period to sue, watch the market go up or down, thereby speculating at the total risk of the wrongdoer. Further it is easier to discover fraud in the

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* *See also Roberts v. Magnetic Metals Co.*, 611 F.2d 450, 454, 463 (3d Cir. 1979) ("much can be said . . . for a different rule . . . directing a federal court to statutes of limitations governing analogous federal causes of action"); *Bader v. Fleschner*, 463 F.Supp. 976, 981 (S.D.N.Y. 1978) (Tenney, J.); *Mittendorf v. J.R. Williston & Beane, Inc.*, 372 F.Supp. 821, 830 (S.D.N.Y. 1974) (Pollack, J.).

** 15 U.S.C. §§ 77m, 78i(e), 78r(c), 78cc(b).

> sale of securities than in other areas, particularly in light of the disclosure requirements of the Securities Acts and the existence of trading markets which provide periodic *indicia* of the value of the investment. From the other side, corporations should be able to determine at some point in time whether they continue to have contingent liabilities with respect to questionable sales of stock in the past. This information is important to other shareholders of the Company as well as potential future shareholders and creditors who demand, and have a right to know the actual financial condition of the company."*

Accordingly, it is clear, as another commentator has stated, that:

> "[t]he ideal judicial solution to the problems in this area would lie in the adoption by the Supreme Court of a nationally uniform statute of limitations applicable to private actions under Rule 10b-5, based on the obvious analogy to the pattern expressed in the 1933 and 1934 Acts . . . ." (Bateman & Keith, *supra*, 39 U.Mo.L.Rev. at 183).

The Court can and should give effect to Congress's clear intention with respect to statutes of limitation in civil suits arising out of the federal securities laws and provide the uniformity and predictability in 10b-5 actions which the lower courts are unable to provide.

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* Martin, *supra*, 29 Bus. Law. 443, 456 (footnotes omitted).

Conclusion

For the reasons stated above, this petition should be granted.

August 31, 1984

Respectfully submitted,

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APPENDIX A

APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Constitution

The Seventh Amendment of the Constitution provides:

> "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law."

Statutes

Section 18 of the Securities and Exchange Act of 1934, 15 U.S.C. § 78r, provides:

> **"Liability for misleading statements**
>
> **Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.**
>
> (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

Contribution

(b) Every person who becomes liable to make payment under this section may recover contribution as in cases of contract from any person who, if joined in the original suit, would have been liable to make the same payment.

Period of limitations

(c) No action shall be maintained to enforce any liability created under this section unless brought within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued."

APPENDIX B

Appendix B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 77-0014-N

PETER MOSESIAN,

Plaintiff,

v.

PEAT, MARWICK, MITCHELL & CO., *et al.*,

Defendants.

No. 77-0281-N

In re

CHARLES L. FLETCHER and MILTON FREDMAN, as Co-Trustees of ROYAL INNS OF AMERICA, INC., a California corporation, *et al.*,

Plaintiffs,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership, and EARL GAGOSIAN,

Defendants.

PEAT, MARWICK, MITCHELL & CO., a partnership,

Counterclaimant,

v.

ROYAL INNS OF AMERICA, INC., a California corporation, *et al.*,

Counterdefendants.

ORDER GRANTING JUDGMENT NOTWITHSTANDING THE VERDICT AND DENYING NEW TRIAL

This cause came on to be heard on the motion of defendant Peat, Marwick, Mitchell & Co. to set aside the verdict and judgment for plaintiff, Peter Mosesian and the class he represents, and to order

judgment for said defendant in accordance with the previous motion for directed verdict, and in the alternative for a new trial, and the court having heard the argument of counsel, and being fully advised, it is

ORDERED, (1) That the verdict and judgment be set aside and that judgment be entered herein for defendant; and it is further

ORDERED, (2) That the defendant's motion for new trial be denied; and it is further

ORDERED, (3) That the trial date of March 15, 1983 be hereby vacated and the jury herein be released and dismissed.

Dated: February 7, 1983

/s/ LELAND C. NIELSEN
United States District Judge

ENTERED
Feb 11 1983
Clerk, U.S. District Court
Southern District of California
By I. MILLER, Deputy

FILED
Feb 7 1983
Clerk, U.S. District Court
Southern District of California
By I. MILLER, Deputy

APPENDIX C

APPENDIX C

UNITED STATES COURT OF APPEALS

NINTH CIRCUIT

Argued and Submitted Nov. 7, 1983

Decided March 7, 1984

Nos. 83-5638, 83-5639

PETER MOSESIAN,

Plaintiff-Appellant,

v.

PEAT, MARWICK, MITCHELL & CO., et al.,

Defendants-Appellees,

CHARLES L. FLETCHER and MILTON FREDMAN, as Co-Trustees of Royal Inns of America, Inc., a California corporation, et al.,

Plaintiffs-Appellants,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership, and EARL GAGOSIAN,

Defendants-Appellees.

Melvyn I. Weiss, New York City, William S. Dato, David J. Yardley, Milberg, Weiss, Bershad, Specthrie & Lerach, San Diego, Cal., for plaintiffs-appellants.

Victor M. Earle, III, Peat, Marwick, Mitchell & Co., New York City, for defendants-appellees.

Appeal from the United States District Court for the Southern District of California.

Before: CHOY and ANDERSON, Circuit Judges, and SOLOMON,* District Judge.

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* The Honorable Gus J. Solomon, Senior United States District Judge for the District of Oregon, sitting by designation.

SOLOMON, Senior District Judge:

These appeals present the issue of when the statutes of limitations began to run in these securities fraud cases.

Peter Mosesian, appellant, on behalf of himself and the other stockholders of Royal Inns of America, Inc. (Royal Inns), filed an action against the company's auditor Peat, Marwick, Mitchell & Co. (Peat Marwick). He alleged that Peat Marwick, in violation of its duty as a certified public accountant, issued false and misleading reports on the financial condition of Royal Inns and affiliated companies. He further alleged that on the basis of these reports, he and other stockholders purchased or held Royal Inns stock and lost money.

Charles L. Fletcher and Milton Fredman, co-trustees in the bankruptcy of Royal Inns, filed an action on behalf of the bankruptcy estate against Peat Marwick on many grounds. They seek to recover the fees Royal Inns paid Peat Marwick to audit its books and the overpayments of income taxes resulting from Peat Marwick's improper accounting methods.

Peat Marwick denied these allegations and raised a number of affirmative defenses including the statute of limitations. The court segregated the statute of limitations defense and granted appellants a jury trial on that issue. The jury in the class action case rejected the statute of limitations defense and found that the class action was timely filed. The court entered judgment for Peat Marwick notwithstanding the verdict.

On the trustees' case, the court, on its own motion at the conclusion of the evidence, directed a verdict in favor of Peat Marwick.

Mosesian and the trustees appeal.

Facts

Royal Inns was a public corporation with about 8,000 shareholders. It was founded in 1965 by Earl Gagosian with the idea of having the corporation enter into a number of limited partnerships with investors to build and operate motor hotels. It later expanded, and through subsidiaries, followed the same format to build and operate restaurants (Jolly Kings) and lounges (Lost Knights) in or

near Royal Inns hotels. By 1973, there were sixty-nine Royal Inns hotels, fifty-two Jolly Kings restaurants and forty-five Lost Knights cocktail lounges.

In 1967, Royal Inns hired Peat Marwick as its auditor. To deal with Royal Inns' form of enterprise, Peat Marwick used two accounting procedures which are the basis of both of these actions.

First, Royal Inns listed as income "advances to" and "investments in" its joint ventures and limited partnerships. Royal Inns reported these items, so-called "receivables," at full value until 1972, when it established a huge reserve for bad debts. Plaintiffs alleged that a larger bad debt reserve should have been established before 1972.

Second, Royal Inns reported as income a construction fee, known as "development and construction profit" (DCP), which was equal to part of the capital investment of the other partners to its joint ventures. This concept allowed Royal Inns to recognize income on its construction projects although construction costs exceeded capital investment plus mortgage financing.

Royal Inns suffered losses from the operation of its hotels, restaurants and lounges, but its financial statements showed more than $7 million in DCP income over a period of several years. As long as it continued to expand and build new projects, Royal Inns could continue to claim DCP income on its books which exceeded operating losses and thereby show a net profit. Actually, however, new projects entailed increased operating losses.[1] When expansion slowed and there was less DCP to offset the operating losses, the financial statements began to show Royal Inns in a serious financial condition.

In 1975, Royal Inns filed a petition for reorganization under Chapter X of the old Bankruptcy Act.[2] The bankruptcy trustees investigated the collapse of Royal Inns and on December 22, 1976 submitted a detailed report that identified questionable accounting

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1. In 1970, Royal Inns reported operating losses of $846,785. In 1972, its operating losses were $2,835,927.

2. Reorganization is now Chapter 11 of the new Bankruptcy Code.

practices used by Peat Marwick and attributed in part the company's problems to those practices. Shortly after the report was made public, Peter Mosesian filed an action against Peat Marwick and others[3] on behalf of himself and the other Royal Inns shareholders. Mosesian alleged violations of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and of Rule 10b-5, 17 C.F.R. § 240.10b-5. He also alleged common law fraud and breach of fiduciary duty.

The bankruptcy trustees brought a separate action on behalf of Royal Inns against Peat Marwick and Earl Gagosian. The trustees alleged conspiracy, breach of fiduciary duty, fraud, negligence, breach of contract, and a violation of former California Corporation Code § 3018. They sought to recover the fees Royal Inns paid Peat Marwick to audit its books, and also the income tax Royal Inns paid on DCP because they contend that DCP should not have been reported as income.

Because the events which form the basis of both actions occurred more than three years before the actions were filed, Peat Marwick raised a statute of limitations defense in each action. In the class action, Mosesian asserts that the three-year statute did not begin to run until the wrongdoing was discovered or until a reasonably prudent investor would have discovered it. Mosesian asserts that a reasonably prudent investor would not have been alerted or would not have discovered the wrongdoing until the trustees' report was made public just a few months before he filed the action. The district court bifurcated the trial and limited the first phase to the issue of when a reasonably prudent investor would have discovered the alleged wrongdoing. The jury[4] found that the action was timely filed.

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3. A number of individuals involved with the corporation were named as defendants. Most settled with the class, and the settlement agreement was approved by the court. Only Peat Marwick is actively defending in this action.

4. There is no merit in Peat Marwick's contention that Mosesian was not entitled to a jury determination on the statute of limitations issue. *See Hilton v. Mumaw*, 522 F.2d 588, 601-02 (9th Cir.1975) (discussion of whether it is ever proper in a 10b-5 case to direct a verdict on the issue of the date upon which the plaintiff had a reasonable opportunity to discover the fraud); *State of Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687, 694 (10th Cir.1981) (in an action under section 10(b), if the evidence does not permit the judge to decide as a matter of law that the plaintiff should have known about the fraud, then "a jury ultimately deciding the facts will determine whether the action accrued too remotely").

but the district court granted Peat Marwick's motion for a judgment notwithstanding the verdict. Mosesian appeals.

The trustees in their action sought to avoid the statute of limitations defense. They assert that Earl Gagosian, the founder and president of Royal Inns, was involved in the fraudulent scheme, and that he dominated Royal Inns to such an extent that the company was incapable of bringing this action earlier. At the conclusion of the evidence, the district court on its own motion directed a verdict against the trustees. The trustees appeal.

Discussion

I. The Class Action

Congress did not provide a statute of limitations for private actions brought under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The federal courts therefore borrow the forum state's statute of limitations for fraud actions. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 210 n. 29, 96 S.Ct. 1375, 1389 n. 29, 47 L.Ed.2d 668 (1976); *Hilton v. Mumaw*, 522 F.2d 588, 601 (9th Cir.1975). The California three-year limit applies here. Cal. Code Civ.P. § 338(4); *United California Bank v. Salik*, 481 F.2d 1012 (9th Cir.), *cert. denied*, 414 U.S. 1004, 94 S.Ct. 361, 38 L.Ed.2d 240 (1973).[5] State law determines the length of the limitations period; federal law determines when the period begins to run, *Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1309 (9th Cir.1982), which in this action is the date plaintiff discovered the fraud or could have done so in the exercise of reasonable diligence, *id.; Hilton v. Mumaw*, 522 F.2d at 602.

5. Peat Marwick urges us to apply instead the limitations period of section 18 of the Securities Exchange Act of 1934, 15 U.S.C. § 78r(c). We decline. That section requires an action to be commenced "within one year after the discovery of the facts constituting the cause of action and within three years after such cause of action accrued." By its own terms, however, the limitations period in subsection 78r(c) applies only to "liability created under this section [78r]." Because Mosesian does not contend that Peat Marwick is liable under section 78r, that section's limitations period is inapplicable.

In addition, applying a period other than that of Cal.Code Civ.P. § 338 to a securities fraud case arising in California would be contrary to the law of this circuit. *E.g., United California Bank v. Salik, supra.*

Mosesian filed the class action complaint in January, 1977. The action is time-barred if Mosesian discovered or should have discovered the alleged wrongdoing before January, 1974. The question of when it was or should have been discovered is a question of fact. *Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d at 1309; *Robuck v. Dean Witter & Co., Inc.*, 649 F.2d 641, 644 (9th Cir.1980); *Hilton v. Mumaw*, 522 F.2d at 602. It may be decided as a matter of law only when "uncontroverted evidence irrefutably demonstrates plaintiff discovered or should have discovered the fraudulent conduct." *Kramas v. Security Gas & Oil Inc.*, 672 F.2d 766, 770 (9th Cir.), *cert. denied*, 459 U.S. 1035, 103 S.Ct. 444, 74 L.Ed.2d 600 (1982).

The standard is no less exacting, and is probably more exacting, when a court sets aside a jury verdict. A judgment notwithstanding the verdict is appropriate when "the evidence permits only one reasonable conclusion as to the verdict." *Flores v. Pierce*, 617 F.2d 1386, 1389 (9th Cir.1980) (quoting *Kay v. Cessna Aircraft Co.*, 548 F.2d 1370, 1372 (9th Cir.1977)). Neither the district court nor this court may weigh the evidence or order a result it finds more reasonable if substantial evidence supports the jury verdict. *William Inglis & Sons Baking Co. v. ITT Continental Baking Company, Inc.*, 668 F.2d 1014, 1026 (9th Cir.1981), *cert. denied*, 459 U.S. 825, 103 S.Ct. 57, 74 L.Ed.2d 61 (1982).

Peat Marwick asserted that DCP was a generally accepted accounting practice at the time it prepared these statements, and it denies any wrongdoing. Nevertheless, it identifies seven "red flag" events which occurred in 1972 and 1973 and which it contends are sufficient as a matter of law to alert a reasonably prudent investor of wrongdoing on the part of Peat Marwick.

1. *Sudden Losses.* In each year from 1967 to 1971, Royal Inns reported a profit. In 1971, the profit was $1.1 million. In 1972, it reported a loss of $1.8 million.

2. *"Going Concern" Qualification.* In Royal Inns' 1972 annual report to stockholders, released in April, 1973, the report recited some of Royal Inns' financial difficulties and concluded: "Continuation of the Company as a going concern is dependent upon obtaining additional financing and negotiating satisfactory arrangements with the bank and creditors." But the report also asserts: "The accompanying financial statements have been prepared in con-

formity with generally accepted accounting principles which contemplate the continuation of the Company as a going concern."

3. *Decline in Stock Price.* On January 28, 1972, Royal Inns' stock was listed on the American Stock Exchange at $26.25 a share. On February 23, 1973, the price was $7.125 a share.

4. *Suspension of Trading.* On February 26, 1973, Royal Inns requested and received a suspension of trading in its stock on both the American and Pacific Coast stock exchanges. Neither exchange permitted further trading in spite of several requests by Royal Inns that trading be allowed to resume.

5. *Difficulty with Creditors.* In March, 1973, Royal Inns consulted a bankruptcy attorney for advice on its problems with creditors. This was widely reported in newspapers. Royal Inns and its creditors worked out a temporary moratorium on collections.

6. *Gagosian Resignation.* In March, 1973, Earl Gagosian resigned as the president and chief executive officer of Royal Inns. He continued on the board of directors and as a paid consultant.

7. *Class Action Against Jolly Kings Restaurants.* In October, 1972, a class action was filed on behalf of all partners against Jolly Kings restaurants. It alleged, among other things, violations of federal securities laws. Peat Marwick was not named as a defendant.

Mosesian admits he was aware of some of these events but he did not suspect that the reported earnings were inflated by the use of either the DCP concept or artificially high receivables.[6] He testified

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6. At this point, we are not concerned with the merits of the case. Solely for purposes of deciding the statute of limitations issue, we assume that Mosesian can prove his allegations that Peat Marwick acted improperly. The district court in granting Peat Marwick's motion for judgment nothwithstanding the verdict, stated:

> before I see this court spending, I would think, more than eight weeks together with the jury on the merits of this matter, I want to be told that there was enough evidence to warrant a trial on the merits. If there was obviously we'll have a trial on the merits, so I deny the motion for a new trial, but I'm going to grant a motion for judgment notwithstanding the verdict. . . .

The district court erred insofar as it based its decision on a consideration of the merits of the case. Mosesian was not required to prove the merits of his case in this first phase, which was limited to whether the action was timely filed, and it was premature for the district court to consider the merits.

that he did not suspect wrongdoing until the trustees' report was published in December, 1976.

An accounting expert called by Mosesian testified that nothing in his examination of the materials available to the public in 1973 made him suspect that DCP and accounts receivables were not reported in accordance with generally accepted accounting principles. An accounting expert called by Peat Marwick testified that after examining the books for four to five hours he was able to evaluate the propriety of the accounting and auditing practices used. He concluded that some of the information in the financial statements raised questions about Peat Marwick's practices, but he found no improprieties.

Most of the red flag events make it obvious that the company was in a poor financial condition. Peat Marwick reported the losses in the 1972 financial statement. Financial problems, however, do not necessarily suggest accounting fraud. Sudden losses, the "going concern" qualification, a decline in stock price, suspension of trading, difficulty with creditors, and the resignation of top management may also be explained by financial mismanagement, cost overruns, general market conditions, or other events unrelated to accounting fraud. *See Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d at 1310; *Admiralty Fund v. Jones*, 677 F.2d 1289, 1294 (9th Cir.1982); *Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1368 (9th Cir.1978).

In *Kramas v. Security Gas & Oil, Inc.*, 672 F.2d 766 (9th Cir.), *cert. denied*, 459 U.S. 1035, 103 S.Ct. 444, 74 L.Ed.2d 600 (1982), a case cited by Peat Marwick, the plaintiff actually knew of the alleged fraud. He consulted with the SEC and suggested to other investors the possibility of an action for fraud. There is no evidence here that Mosesian actually suspected fraud at any time before the trustees made their report public.

In other cases cited by Peat Marwick, in which the court disposed of notice issues as a matter of law, the representations made were contrary to well-known and highly publicized information which was generally available. *E.g. Jablon v. Dean Witter & Co.*, 614 F.2d 677 (9th Cir.1980); *Gaudin v. KDI Corp.*, 576 F.2d 708 (6th Cir.1978); *Hupp v. Gray*, 500 F.2d 993 (7th Cir.1974). Here, the events on which Peat Marwick relies are not obviously inconsistent with the financial statements.

There is no merit in Peat Marwick's contention that the class action complaint in *Serpa v. Jolly King Restaurants, Inc.*, No. 72–423–N (S.D.Cal. filed Oct. 10, 1972) was sufficient to notify Mosesian of Peat Marwick's alleged wrongdoing. Although other actions alleging similar misrepresentations may be a factor in deciding whether a plaintiff had notice, *Serpa* is not such a case. Peat Marwick is not mentioned, and there is no reference to overvalued receivables or DCP. We cannot say that as a matter of law the *Serpa* case put an informed stockholder of Royal Inns on notice that Peat Marwick was guilty of fraud or other misconduct.

We find nothing in the record before the publication of the trustees' report in December, 1976 that would, as a matter of law, require Mosesian and other members of the class to question the legitimacy of Peat Marwick's accounting and auditing procedures.

The question of what a reasonably prudent investor should have known is particularly suited to a jury determination. The jury could have reached various conclusions from the evidence. In our view, the one it reached was reasonable and is supported by substantial evidence. It was therefore inappropriate for the district court to grant Peat Marwick's motion for a judgment notwithstanding the verdict. The judgment is reversed and the jury verdict reinstated. The case is remanded for a trial on the merits.

II. The Trustees' Action

The bankruptcy trustees filed their action in April, 1977. Peat Marwick raised a statute of limitations defense. The trustees sought to avoid the defense on the ground that Royal Inns was so dominated by Gagosian that the company itself was unable to bring this action earlier.

A plaintiff who seeks to toll the statute because the corporation was dominated must show "full, complete and exclusive control in the directors or officers charged." *International Railways of Central America v. United Fruit Co.*, 373 F.2d 408, 414 (2d Cir.1967). The test is that "once the facts giving rise to possible liability are known, the plaintiff must effectively negate the possibility that an informed stockholder or director could have induced the corporation to sue." *Id.*

The district court, on its own motion, directed a verdict against the trustees for all claims arising out of activities that occurred before 1972.[7] The Court found no evidence in the record of domination. The trustees concede the lack of evidence in the record, but they assert that the district court improperly excluded their evidence on that issue.

The trustees contend that the rejected evidence, consisting of their testimony and report and the testimony of their attorney and accountant, supports their allegation that Gagosian dominated Royal Inns. However, we have examined the offer of proof of those witnesses, and we do not find any mention of domination or any facts from which domination can be reasonably inferred.

Some statements in the 61-page trustees' report may present evidence of domination. However, much of the report contains hearsay.[8] The district court need not separate the admissible parts from the inadmissible parts but can reject the entire offer. *Lane v. United States*, 142 F.2d 249, 253 (9th Cir.1944). It was not error to reject the report.

The trustees may have been able to offer other evidence that Gagosian dominated Royal Inns, but no admissible evidence of domination was offered. The district court properly directed a verdict in favor of Peat Marwick on the ground that the trustees' action was not timely filed.

There is no merit in any of the other contentions raised by the parties.

---

7. The trustees' causes of action based on the 1973 financial statement are still to be tried.

8. Examples from just the one paragraph of the report principally relied on by the trustees include the statements: "Gagosian has been described as a tyrant when it came to managing the affairs of Royal Inns," and "during the Company's crisis in late 1972, he [Gagosian] directed Company employees to withhold information from the Board." These statements without supporting information or identification of the persons making these statements are hearsay.

Conclusion

There is substantial evidence to support the jury verdict in favor of Mosesian. It was error for the district court to grant a judgment notwithstanding the verdict. The district court's judgment in favor of Peat Marwick is reversed and the jury verdict reinstated.

There is a lack of evidence that Gagosian dominated Royal Inns. Accordingly, we affirm the district court's decision to direct a verdict against the trustees.

Affirmed in part and reversed and remanded in part.

APPENDIX D

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 83-5638

PETER MOSESIAN,
Plaintiff-Appellant,

v.

PEAT, MARWICK, MITCHELL & CO., et al.,
Defendants-Appellees,

No. 83-5639

In re

CHARLES L. FLETCHER and MILTON FREDMAN, as Co-Trustees of ROYAL INNS OF AMERICA, INC., a California corporation, et al.,
Plaintiffs-Appellants,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership, and EARL GAGOSIAN,
Defendants-Appellees.

ORDER

Before: CHOY and ANDERSON, Circuit Judges, and SOLOMON,* District Judge.

The panel as constituted in the above case has voted to deny the petition for rehearing and to reject the suggestion for rehearing en banc.

---

* The Honorable Gus J. Solomon, Senior United States District Judge for the District of Oregon, sitting by designation.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has voted to grant rehearing en banc. Fed.R.App.P. 35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

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Clerk, U.S. Court of Appeals

No. 84-334

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IN THE

Supreme Court of the United States

October Term, 1984

PEAT, MARWICK, MITCHELL & CO.,

Petitioner,

--against--

PETER MOSESIAN,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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No. 84-334

IN THE

Supreme Court of the United States

October Term, 1984

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--against--

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Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
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FOR THE NINTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

OPINIONS BELOW

The opinion of the Ninth Circuit (Petitioner's Appendix C-1) is reported at 727 F.2d 873. The Order of the District Court for the Southern District of California is printed at Petitioner's Appendix at page B-1.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petition.

STATEMENT

The facts of the case are stated fully in the decision of the Court of Appeals (Petitioner's Appendix C at pp. 2-9).

ARGUMENT

This case presents no issues worthy of certiorari.

After a bifurcated trial limited to statute of limitations issues, the jury found that the statute did not bar the complaint. The district court, apparently disagreeing with the jury's fact-finding, granted a judgment notwithstanding the verdict, thus upholding the limitations defense. The Court of Appeal for the Ninth Circuit properly reversed, making a routine application of JNOV principles, determining simply that the district court erred in replacing the jury's verdict with its own.

The Ninth Circuit's routine application of limitations and JNOV principles certainly presents no occasion for a grant of *certiorari*. Similarly, there is no need for this Court to reconsider the long-established constitutional right to jury trial on factual issues presented by a limitations defense, or the well-settled principle that state statutes of limitations are to be borrowed in securities cases arising under § 10(b) of the Securities Exchange Act of 1934.

I.

THE NINTH CIRCUIT'S DECISION THAT THE STATUTE OF LIMITATIONS HAD NOT RUN ON THIS SHAREHOLDERS' CLASS ACTION WAS NOT IN CONFLICT WITH DECISIONS OF THIS COURT OR COURTS OF APPEAL

Peat, Marwick, Mitchell & Co's ("Peat") central contention in support of its Petition is that the Ninth Circuit departed from decisions of this Court and those of the Courts of Appeal concerning the running of the Statute of Limitations on a claim under Section 10b of the Securities Exchange Act of 1934 in this shareholders' class action. Only by characterizing the Ninth Circuit's opinion as standing for various principles which the Ninth Circuit did not adopt does Peat have any basis to claim that grounds for its Petition even exist.

However, contrary to Peat's assertion, the opinion below is entirely consistent with both this Court's decisions and those of other Courts of Appeal and provides no grounds for the use of this Court's extraordinary review power. Peat's primary reliance on *Wood v. Carpenter*, 101 U.S. 135 (1879) is misplaced. As this Court held there:

> "Whatever is notice enough to excite attention and put the party on his guard and call for inquiry, is notice of everything to which such inquiry might have led. When a person has sufficient information to lead him to a fact, he shall be deemed conversant of it."

101 U.S. at 141.

To attempt to bring itself within the holding of *Wood*, Peat cites seven "red flag" events (primarily adverse business events) which it concludes must have triggered an earlier investigation by plaintiff into Peat's fraudulent conduct, as a matter of law. However, as the Ninth Circuit properly held, none of these events suggested the *cause* of the harm which forms the basis of plaintiff's complaint, Peat's improper accounting practices:

> Most of the red flag events make it obvious that the company was in a poor financial condition. Peat Marwick reported the losses in the 1972 financial statement. Financial problems, however, do not necessarily suggest accounting fraud. Sudden losses, the "going concern" qualification, a decline in stock price, suspension of trading, difficulty with creditors, and the resignation of top management may also be explained by financial mismanagement, cost overruns, general market conditions, or other events unrelated to *accounting fraud*. *See Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d at 1310; *Admiralty Fund v. Jones*, 677 F.2d 1289, 1294 (9th Cir. 1982); *Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1368 (9th Cir. 1978).

(Petitioner's App. at C-8)

Simply put, "notice" of the red flag events sufficient to "call for inquiry" would not have led plaintiff to the "fact" of Peat's wrongful conduct. Both the jury which heard the evidence and the Court of Appeals so found. This was a factual issue which the jury decided

favorably to plaintiff, and which the Court of Appeals properly held could not be overturned by a JNOV.

For the same reason, the Court of Appeals decision is consistent with *United States v. Kubrick*, 444 U.S. 111 (1979) also relied on by Peat. In *Kubrick*, it was undisputed that the plaintiff was aware of both the fact of his injury "and its probable cause," (*Id.* 444 U.S. at 118) more than two years prior to the filing of his suit under the Federal Tort Claims Act. As the Court noted:

> We are unconvinced that for statute of limitations purposes a plaintiff's ignorance of his legal rights and his ignorance of the fact of his injury or its cause should receive identical treatment. That he has been injured in fact may be unknown or unknowable until the injury manifests itself; and the facts about causation may be in the control of the putative defendant, unavailable to the plaintiff or at least very difficult to obtain. The prospect is not so bleak for a plaintiff in possession of the critical facts that he has been hurt *and who has inflicted the injury*.

Id. 444 U.S. at 122 (emhasis added).

What distinguishes the present case from *Kubrick* is plaintiff's lack of knowledge of the *cause* of the injury, Peat's fraudulent accounting practices, a fact which did not become known until the publication of the Royal Inns Co-Trustees' report less than one month prior to the commencement of this action.

Nor is the Court of Appeals decision at odds with those of other Circuits. In the Ninth Circuit the standard for when a limitations period in a securities fraud action begins to run is the point at which the plaintiff has "knowledge of facts sufficient to make a reasonably prudent person suspicious of *fraud*. . . ." *Robuck v. Dean Witter & Co.*, 649 F.2d 641, 644 (9th Cir. 1980); *accord Admiralty Fund v. Hugh Johnson & Co.*, 677 F.2d 1301, 1309 (9th Cir. 1982) ("when the plaintiff discovered or could have discovered the *fraud* with the exercise of reasonable diligence . . ."); *Kramas v. Security Gas & Oil Inc.*, 672 F.2d 766, 770 (9th Cir. 1982) ("when . . . plaintiff discovered or should have discovered the *fraudulent conduct* . . .") (all emphasis added). It is the fact of "deception" which must be discovered. *See Holmberg v. Armbrecht*, 327 U.S. 392, 397

(1946). Something must cause the plaintiff to suspect the *falsity* of prior representations. *Briskin v. Ernst & Ernst*, 589 F.2d 1363, 1367 (9th Cir. 1978).

Virtually every other Circuit Court has adopted and applies a similar test which focuses on the operative word "fraud" in terms of what must be discovered. *See e.g., Cook v. Avien, Inc.*, 573 F.2d 685, 695 (1st Cir. 1978) ("when plaintiff . . . discovered or should have discovered the fraud of which he complains"); *Breen v. Centex Corp.*, 695 F.2d 907, 911 (5th Cir. 1983) ("when [plaintiffs] knew or . . .should have known of [the defendant's] alleged fraudulent conduct"); *Herm v. Stafford*, 663 F.2d 669, 682 (6th Cir. 1981) ("when 'the fraud is or should have been discovered'"); *Vanderboom v. Sexton*, 422 F.2d 1233, 1240 (8th Cir. 1970) ("the date the fraud upon reasonable inquiry should have been discovered"); *accord* 5 C. Jacobs: *Litigation and Practice Under Rule 10b-5*, § 235.03 at 10-31 (2d ed. 1984) (the limitations period "begins to run when plaintiff knew or should have known of the fraud.").

In summary, the Court of Appeals correctly decided the issue, consistent with this Court's prior decisions and those of other Circuits on the statute of limitations and consistent with indisputable JNOV principles.

Peat's additional arguments that: (i) the Ninth Circuit decision protects only the guilty; (ii) that a statute of limitations can no longer run in "accounting fraud" cases; and (iii) that the decision below puts defendants charged with fraud to an election of defenses, borders on the specious and provides no basis for the issuance of a writ of certiorari. Peat's problem is of its own making, as it successfully insisted on a bifurcated trial, then improperly put in evidence of its supposed innocence, but now takes offense at the use of this evidence by plaintiff and the Court of Appeals in illustrating why a reasonable shareholder would not have suspected accounting fraud during the crucial time period. Only because of its abuse of the bifurcated proceedings is Peat able to argue that it has been abused by the Ninth Circuit's decision because it is innocent of any wrongdoing.

II.

PLAINTIFF WAS ENTITLED TO A JURY TRIAL ON THE STATUTE OF LIMITATION ISSUE

Peat has consistently contended throughout these proceedings that, despite well-established constitutional decisions to the contrary, the plaintiff and the class should be deprived of a jury trial on the statute of limitations issue. Both the trial court and the Ninth Circuit disagreed. Those views need not and should not be disturbed here. Simply put, the issue before the District Court in the first phase of the trial was ". . . when a reasonably prudent investor would have discovered the alleged wrongdoing." (Petitioners Appendix C at C-4.) As the Ninth Circuit properly held:

> The question of what a reasonably prudent investor should have known is particularly suited to a jury determination. The jury could have reached various conclusions from the evidence. In our view, the one it reached was reasonable and is supported by substantial evidence. It was therefore inappropriate for the district court to grant Peat Marwick's motion for judgment notwithstanding the verdict.

(*Id.* at C-9.)

The decision below is in accord with the teachings of this Court and an unbroken line of precedent from other Circuits holding that the question of whether the plaintiff knew or should have known of the fraud at an earlier date is for the jury as the trier of fact to determine. As the Ninth Circuit explained in reversing a summary judgment in favor of defendants on the issue of plaintiffs' discovery of the fraud:

> Great as the burden may be upon a busy court, it is necessary to place before a fact-finder the conflicting recollections of facts and the conflicting inferences to be drawn from such facts in this case. *The conflicting assertions in this case about what a reasonable investor would have known presented issues of the type usually reserved for juries.* The trial court understandably sought to shorten the proceedings by summary judgment, but material questions of fact remained to be tried.

Briskin v. Ernst & Ernst, 589 F.2d 1363, 1369 (9th Cir. 1978) (emphasis added). Similarly, the Second Circuit has concluded "The question whether [plaintiff] exercised due diligence, and thus is not precluded by the statute of limitations from maintaining this action, is a question of fact that should be determined *by the jury* as the trier of the facts." *Robertson v. Seidman & Seidman*, 609 F.2d 583, 592-593 (2d Cir. 1979) (emphasis added). Finally, in language particularly applicable to the instant case, the Fourth Circuit has stated, "It is sufficient for us to say that when, as here, a jury has been demanded and the facts give rise to conflicting inferences on the issue of reasonable diligence, the question *must be submitted to the jury*." *John Hopkins University v. Hutton*, 422 F.2d 1124, 1131 (4th Cir. 1970) (emphasis added). *Accord, Azalea Meats, Inc. v. Muscat*, 386 F.2d 5, 9 (5th Cir. 1967) (reversing summary judgment); *deHaas v. Empire Petroleum Co.*, 435 F.2d 1223, 1227 (10th Cir. 1970) (affirming judgment in favor of plaintiff entered after a jury verdict); *Kubik v. Goldfield*, 479 F.2d 472, 477 n. 12 (3d Cir. 1973) (dictum).

Moreover, given the intensely factual nature of the inquiry involved, this result is supported in both reason and law. The right to a civil jury trial has been jealously guarded by this Court:

> Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.

Dimick v. Schiedt, 293 U.S. 474, 486 (1935). The Court has continually reminded lower courts that "[t]he federal policy favoring jury trials is of historic and continuing strength." *Simler v. Conner*, 372 U.S. 221, 222 (1963); *see also Jacob v. City of New York*, 315 U.S. 752-753 (1942); *Beacon Theatres v. Westover*, 359 U.S. 500, 501 (1959). It has urged federal courts to resolve close cases in favor of extending the right to trial by jury. *See Dixon v. Northwestern Nat. Bank*, 297 F.Supp. 485, 489 (D. Minn. 1969); *Prudential Oil Corp. v. Phillips Petroleum Co.*, 392 F.Supp. 1018, 1022 (S.D.N.Y. 1975).

In challenging this long-standing line of authority, Peat places primary emphasis on *State of Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981). In *Peterson*, the Tenth Circuit considered the propriety of a district court's decision to grant summary judgment to defendant based on its determination that

the plaintiff, the State of Ohio should have discovered the alleged fraud at an earlier date. Rather than applying the traditional summary judgment test -- *i.e.*, whether defendant demonstrated that no issues of material fact exist -- the court reviewed the history of the "reasonable discovery" rule, which it referred to as the federal "tolling" doctrine. Concluding that it was equitable in origin, the Tenth Circuit affirmed the district court's grant of summary judgment, reasoning that the equitable origin allowed the district court judge "some room for discretion." *Id.* at 693.

The *Peterson* court *did not state* that defendant's statute of limitations defense was an equitable issue and/or that a jury was an inappropriate trier of fact on such a defense. The court's holding explicitly limits its reach to the summary judgment procedure -- an issue twice resolved against defendants in the instant case in the District Court -- and specifically contemplated a *jury trial* if issues of fact had remained:

> Where, as here, a § 10(b) action alleges substantially the same facts as in prior litigation, summary disposition is appropriate if the documents before the court clearly and convincingly persuade the trial judge that plaintiff in the exercise of reasonable diligence would have discovered the fraud at such a time as to bar the action. If the documents before the court are not sufficiently persuasive to meet this stringent test, *a jury ultimately deciding the facts will determine by a preponderance of the evidence whether the action accrued too remotely.*

Id. at 694 (emphasis added).

Simply put, Peat's 10b-5 statute of limitations defense, however derived, remains a *legal* defense to a *legal* claim created by federal law, unquestionably bringing it within the ambit of the Seventh Amendment's jury trial guarantee. The fact that one aspect of the defense as it applies to this case may have equitable origins is, perhaps, of historical interest, but cannot deprive plaintiffs of their constitutional right to trial by jury. *See Ross v. Bernard*, 396 U.S. 531, 539-541 (1970).

III.

THE NINTH CIRCUIT AND THE DISTRICT COURT APPLIED THE CORRECT LIMITATIONS PERIOD -- A PERIOD WHICH SHOULD BE CHANGED, IF AT ALL, BY CONGRESS

It has been established since the earliest private litigation under Section 10(b) of the Securities Exchange Act that the applicable statute of limitation is to be borrowed from the comparable state provision. Peat urges the Court to upset this unbroken line of precedent and apply the specifically inapplicable limitations period set forth in Section 18(c) of the 1934 Act -- one year from discovery with an outside limitations period of three years -- to all actions brought pursuant to Section 10b of the 1934 Act. But this is no reason to modify this body of law, and if it were, Congress would be the proper body to do so in legislation with prospective application only. *Stare decisis* alone is enough to demonstrate that Peat is wrong.

Although Peat couches its argument in pejorative terms such as "forum shopping," "securities speculations" and "tactical delay," the end result it seeks by the adoption of the rule it proposes is to prevent this action from reaching trial on the merits by imposing an absolute time bar with no tolling provisions whatsoever. That result is contrary to the teachings of the Court and the strong public policy in favor of private enforcement of the federal securities laws.

First, two recent landmark decisions by this Court, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) and *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983) have noted without criticism the long standing practice of "borrowing" the analogous forum State statute of limitations to be used in actions brought under Section 10b. The practice has been followed virtually without exception by the lower courts. See, 5 C. Jacobs: *Litigation and Practice Under Rule 10b-5* § 235.02 (2d ed. 1984) and cases therein cited.

Second, Peat's reliance upon *DelCostello v. International Brotherhood of Teamsters*, 462 U.S. 151 (1983) is misplaced. The Court in *DelCostello* was presented with an undecided question, not one resolved by a host of prior, consistent decisions, and analyzed the public policy considerations supporting an employee's right to sue his or her employer for breach of a collective bargaining agreement or the union for mishandling a subsequent grievance/arbitration proceeding. The Court

held that the proper statute of limitations was the six month federal limitations period in § 10(b) of the National Labor Relations Act, 29 U.S.C. § 160(b). However, it did so, in part, because it concluded that certain of the analogous state court statutes under consideration were *too short*:

> We conclude that state limitations periods for vacating arbitration awards fail to provide an aggrieved employee with a satisfactory opportunity to vindicate his rights under § 301 and the fair representation doctrine.

Id. ____ U.S. ____, 103 S.Ct. 2281, 2291 (1983).

Peat's implicit assumption that state limitations periods (with or without the application of doctrines of tolling), are *too long* is simply contrary to fact. Although Peat argues that the limitations periods range from as little as one to as long as ten years and that this fact encourages a host of undesirable results (Petitioners' Brief at 24), an analysis of these statistics is revealing. Of the approximately thirty-nine states in which District Courts have "borrowed" a settled limitations period, approximately twenty-nine of them have adopted a period of 3 years or less, providing no factual bases for the abuse Peat claims exists. See 5 C. Jacobs: *Litigation and Practice Under Rule 10b-5* § 235.02 at 10-20 -10-26 (2d ed. 1984).

Moreover, the recent teachings of the Court concerning the importance of enforcement of rights under the Federal Securities Laws seem to make it clear that these rights are better served by a longer limitations period, not a shorter one. *Herman & MacLean v. Huddleston*, 459 U.S. 386-387 ("we have repeatedly recognized that securities laws combating fraud should be construed 'not technically and restrictively, but flexibly to effectuate [their] remedial purposes.'"); *Merrill Lynch Pierce Fenner & Smith v. Curran*, 456 U.S. 353, 387 (1982) ("the private cause of action enhances the enforcement mechanism fostered by Congress . . . [which] evidenced an affirmative intent to preserve this enforcement tool."). The current borrowing practice is consistent with both the analysis of *DelCostello* and this Court's recognition of the importance of the enforcement of private rights under the Federal Securities Laws and should not be changed or limited as Peat suggests. Any such action, if action need be taken should be left to Congress. See 5 C. Jacobs: *Litigation and Practice Under Rule 10b-5* § 235.02 at 10-27 (2d ed. 1984) (suggesting

that changes in the limitations periods are inappropriate because of the reliance prospective litigants place on the old period).

IV.

CONCLUSION

For all of the above reasons, Peat's Petition should be denied.

Respectfully submitted,

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October 12, 1984

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On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S REPLY BRIEF

Petitioner Peat, Marwick, Mitchell & Co. ("PMM") submits this memorandum in reply to the Brief in Opposition filed by Respondent Peter Mosesian ("Respondent") on October 4, 1984.

I.

THE NINTH CIRCUIT'S DECISION CONFLICTS WITH THE DECISIONS OF THE COURT AND THE DECISIONS OF OTHER COURTS OF APPEAL

Respondent's Brief in Opposition, read together with PMM's Petition, squarely presents the conflict between the standard adopted by the Ninth Circuit in this case for determining the applicability of federal equitable tolling doctrine and the standard enunciated by the Court and applied in other courts of appeal.

PMM—relying upon the Court's decision in *Wood v. Carpenter*, 101 U.S. 135, 141 (1879), and the decisions, *inter alia*, of the First, Second, Seventh and Eighth circuits—has shown in its Petition (pp.

10-13) that a two-step test must be applied. The first analytical step is to determine whether plaintiff is on *notice* of facts sufficient to place him under a duty of inquiry—*i.e.* facts which "excite attention and put a party on his guard and call for inquiry." *Wood v. Carpenter, supra,* 101 U.S. at 141. The second step is whether, *upon diligent inquiry,* plaintiff could have discovered the facts alleged to constitute the breach of legal duty—in the present case, "fraud."

As applied here, the two-step test leads to the following conclusions: (1) the "red flag" events (conceded by Respondent and set forth in the Petition at 8-9) constitute "inquiry notice;" (2) they are sufficient, as a matter of law, to "excite attention and put a party on his guard and call for inquiry" (Petition 13-17); and (3) because Respondent conceded below that he made no inquiry, diligent or otherwise, PMM was entitled, as the district court held, to judgment notwithstanding the verdict.

In his Brief in Opposition, Respondent makes no pretense of having satisfied the two-step test set forth above. Indeed, Respondent openly advocates—and the Ninth Circuit has now adopted —a one-step test. As stated in the opinion below, unless the "red flag" events *"necessarily* suggest *accounting fraud"* (*i.e.* unless they cannot be "explained by . . . events unrelated to accounting fraud"), the statute cannot run as a matter of law (App. C-8) (emphasis added). Consistent with this view, Respondent argues that he is entitled to the benefits of federal equitable tolling doctrine because the "red flag" events did not, on their face, lead *directly and without inquiry* to knowledge of what Respondent alleges were "Peat's improper accounting practices." (Br. in Opp. at 3).*

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* Most accounting "fraud" cases (and the present case is no exception) do not involve "fraud" at all. They merely involve situations in which accountants are alleged to have departed from Generally Accepted Accounting Principles ("GAPP") due to claimed errors of judgment which, at most, constitute simple negligence. Plaintiffs typically characterize such conduct as "recklessness," which, some lower courts have held, supports a claim of "fraud" under the Securities and Exchange Act of 1934 ("1934 Act"). The existence of a claim of "fraud," in turn, bootstraps plaintiffs into an array of procedural advantages conceived to deal with intentionally dishonest conduct.

(footnote continued on page 3)

Obviously, the Ninth Circuit's one-step test completely obliterates any requirement that putative fraud plaintiffs be diligent in determining whether they have claims. Its holding that the statute of limitations cannot run as a matter of law until a plaintiff, *without inquiry*, is confronted with facts which *"necessarily* suggest accounting fraud" squarely conflicts with the rule in several other circuits that it runs, as a matter of law, when plaintiff is on notice that "something is amiss." *Hupp* v. *Gray*, 500 F.2d 993, 996-97 (7th Cir. 1974).*

Respondent next attempts to demonstrate that the Ninth Circuit's holding (that the statute does not run until available facts "necessarily suggest *accounting fraud*") can somehow be harmonized with the Court's decision in *United States* v. *Kubrik*, 444 U.S. 111, 125 (1979), where it was specifically held that the statute does not await the discovery of the *breach of legal duty* ultimately alleged (444 U.S. at 125).

Respondent states: "What distinguishes the present case from *Kubrick* is plaintiff's lack of knowledge of the *cause* of the injury, Peat's *fraudulent* accounting practices. . . ." (Br. in Opp. at 4) (emphasis added). But the whole point of *Kubrick* was to separate discovery of cause in fact from discovery of legal cause (*i.e.* injury stemming from breach of a legal duty) and to establish that the statute runs from discovery of the first and not the second. Respondent now seeks to blur this distinction by arguing—directly contrary to *Kubrick*—that the statute should have been suspended

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(footnote continued from page 2)

One such advantage is "federal equitable tolling doctrine." A requirement that putative plaintiffs "discover," without inquiry, that certain accounting practices do not conform to GAAP is as impractical as a requirement that they discover, without inquiry, whether certain medical treatments conform to proper medical standards (*cf. United States* v. *Kubrick*, 444 U.S. 111 (1979)). Such discovery is not difficult because of concealment (as is the case with fraud). It is difficult because it involves a field of technical professional expertise. To dispose of an inquiry requirement in either case is, in effect, to suspend the statute virtually forever.

* *See also Cook* v. *Avien, Inc.*, 573 F.2d 685, 695-96 (1st Cir. 1978); *Buder* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 644 F.2d 690, 693 (8th Cir. 1981); *Arneil* v. *Ramsey*, 550 F.2d 774, 781 (2d Cir. 1977).

until Respondent discovered PMM's alleged "fraudulent accounting practices"—*i.e.* its alleged breach of legal duty.

Respondent finally argues (Br. in Opp. at 4-5) that a number of other Ninth Circuit cases hold that there is no duty of diligent inquiry and that the statute awaits the discovery of the breach of legal duty alleged. PMM agrees that the Ninth Circuit has generally adopted a federal equitable tolling standard which is inconsistent with *Kubrick* and *Wood* as well as the standard applied in other courts of appeal.*

In conclusion, the one-step test advocated by Respondents and upheld by the Ninth Circuit conflicts with the decisions of other courts of appeal; it is contrary to the law as enunciated by the Court in *Wood* v. *Carpenter* and *United States* v. *Kubrick;* and, as PMM demonstrated in its Petition (pp. 17-19), it leads to injustice and defeats the important policies underlying statutes of limitation without in any way deterring fraud.

I I.

THE SEVENTH AMENDMENT DOES NOT "PRESERVE" ANY RIGHT TO A JURY TRIAL ON THE APPLICABILITY OF FEDERAL EQUITABLE TOLLING DOCTRINE

Respondent, although conceding that federal equitable tolling doctrine "may have equitable origins" (Br. in Opp. at 8), argues that the Court should nonetheless conclude that the Seventh Amendment "preserves" a right to a jury trial on tolling issues (1) because of the "intensely factual nature of the inquiry involved" (*id.* at 7) and (2) because "an unbroken line of precedent from other Circuits" has treated tolling questions as questions for the jury (*id.* at 6). Neither of these arguments withstands analysis.

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* Respondent's suggestion that *Cook* v. *Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978), follows the Ninth Circuit's standard is simply wrong, as a review of that opinion demonstrates. Although it is true that the First Circuit there refers to discovery of the "fraud," the decision makes it plain that inquiry notice was there held to have arisen on the basis of circumstances virtually identical to those in this case.

The remaining cases cited by Respondent from circuits other than the Ninth Circuit (Br. in Opp. at 5) are either consistent (on their facts) with PMM's position here or serve to demonstrate the very confusion and conflict which the Court should resolve.

First, contrary to Respondent's suggestion, there is no such thing as a "jury type" issue (J. Moore, *Federal Practice*, ¶ 38.16[4] at 38-154, ¶ 38.17 at 38-155 to 38-158 (1984)). A plaintiff seeking damages on an issue is generally entitled to a jury trial; a plaintiff seeking an injunction on the same issue must try his case to the court. Thus, as the Court has repeatedly held, the controlling question, in determining whether the Seventh Amendment "preserves" a right to a jury trial with respect to a particular issue is whether that issue was deemed legal or equitable in 1791, when the Seventh Amendment was enacted. Respondent does not (and cannot) contend that tolling issues were not deemed equitable in 1791. They clearly were (Petition at 19-23). Accordingly, the supposedly "intensely factual" nature of tolling issues does not confer any Seventh Amendment right on Respondent.

Nor can the courts of appeal—however unanimous—re-write history or create a Seventh Amendment right where none exists. PMM is aware of only one decision, *State of Ohio* v. *Peterson, Lowry, Rall, Barber & Ross*, 651 F.2d 687 (10th Cir.), *cert. denied*, 454 U.S. 895 (1981), in which a federal court of appeals has even indirectly given any consideration to the historical questions relevant to Seventh Amendment analysis.* Otherwise, certain lower federal courts appear to have uncritically assumed that tolling issues should be assigned to the jury where a jury is the trier of fact.

Nonetheless, the unalterable fact (as shown in the Petition at 19-23) is that, in 1791, an otherwise time-barred litigant could obtain a tolling of the statute of limitations only in a court of equity. Respondent does not contend that this is incorrect. It follows that the Seventh Amendment does not "preserve" any jury trial right with

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* There, the Tenth Circuit recited some of the historical background set forth in the Petition (pp. 20-21) and concluded that the doctrine was indeed an equitable one. The precise question before the court, however, was the proper scope of the lower court's discretion in granting summary judgment on tolling issues; the question of whether a jury trial is ever appropriate on such issues does not appear to have been posed. The court concluded that the equitable origins of tolling doctrine supported a more expansive view of the district court's discretion in granting summary judgment on statute of limitations grounds where tolling has been asserted (651 F.2d at 692-93).

respect to tolling issues and that PMM was entitled to a non-jury trial on those issues in the bifurcated trial below.*

III.

THE LIMITATIONS PERIOD SET FORTH IN SECTION 18(c) OF THE 1934 ACT SHOULD GOVERN CIVIL ACTIONS ARISING UNDER SECTION 10(b)

In its Petition, PMM argued (1) that the current practice in the federal courts of applying "analogous" state statutes of limitation in actions arising under Section 10(b) of the 1934 Act (15 U.S.C. § 78j(b)) encourages forum shopping, securities speculation and tactical delay; (2) that every objective commentator to consider the question has deplored this situation and argued for an analogy to the limitations provisions of the 1934 Act instead; (3) that many courts, although bound by precedent, have expressed the same view; and (4) that the Court has, fairly recently, recognized that the borrowing of analogous federal statutes of limitation is preferable when such an analogy serves to advance federal policies (Petition at 25-27).

Respondent now trivializes the legitimate and widely recognized concerns raised in the Petition, argues that Congress is the proper entity to create a statute of limitations to govern a judicially-created remedy, and concludes that, however unfortunate the consequences, things should stay the way they are now because they have always been that way (Br. in Opp. at 9-11).

Merely to state these arguments is to reject them. However, for the sake of clarity, the following points are worth noting.

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* Rule 38(a) of the Federal Rules of Civil Procedure provides for jury trial as of right only where the Seventh Amendment or some federal statute provides for such a right. Where, as here, no right to a jury trial exists, a jury can render a binding verdict only "with the consent of both parties." Fed. R. Civ. P. 39(c). Since PMM did not so consent (and, indeed, has consistently contested the propriety of a jury trial on tolling issues), the jury's verdict could not have been binding on the district court. *See Armco, Inc.* v. *Armco Burglar Alarm Co., Inc.*, 693 F.2d 1155, 1158 (5th Cir. 1982); *Morelock* v. *NCR Corp.*, 546 F.2d 682, 689 (6th Cir. 1976), *vacated on different grounds*, 435 U.S. 911 (1978); *Hyde Properties* v. *McCoy*, 507 F.2d 301, 306 (6th Cir. 1974); *Cargill, Inc.* v. *Commodity Credit Corp.*, 275 F.2d 745 (2d. Cir. 1960); *Hurwitz* v. *Hurwitz*, 136 F.2d 796, 799 (D.C. Cir. 1943).

First, the essence of PMM's argument is not (as Respondent suggests) that "state limitations periods . . . are *too long*" (Br. in Opp. at 10) (emphasis in original); it is that those limitations periods are *too inconsistent*. This inconsistency, particularly when coupled with completely open-ended tolling doctrines, encourages forum shopping and makes it impossible for companies transacting business nationally to predict when, if ever, their exposure to federal securities fraud liability in connection with a given transaction has ended.

Second, contrary to Respondent's suggestion, nothing in PMM's Petition is inconsistent with "the strong public policy in favor of private enforcement of the federal securities laws" (Br. in Opp. at 9). PMM does not advocate repeal of the federal securities laws. It merely seeks greater predictability in the selection and application of the statutes of limitation governing those laws.

Third, the limitations period set forth in Section 18(c) of the 1934 Act (15 U.S.C. § 78r(c)) is not "specifically inapplicable" to actions arising under Section 10(b) (Br. in Opp. at 9). It is as available for "borrowing" by analogy as any state statute, and, indeed, if logic and policy are a guide, it is far more appropriately available. L. Loss, *Securities Regulation* at 3899-3900 (1969 Supp.).

Finally, the fact that the Court has "noted without criticism" (Br. in Opp. at 9) the current practice of the lower federal courts in this area does not suggest approval or insulate that practice from challenge here.

In short, Respondent simply argues that things should stay the way they are because they are that way. Here, strong policy reasons argue for change. PMM submits that the time for change has arrived.

CONCLUSION

For the reasons stated above and in the Petition, certiorari should be granted.

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